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Risk management and transfer industry gears up for Brexit

◇ BREXIT

Ben Norris & Stuart Collins
news@commercialriskonline.com

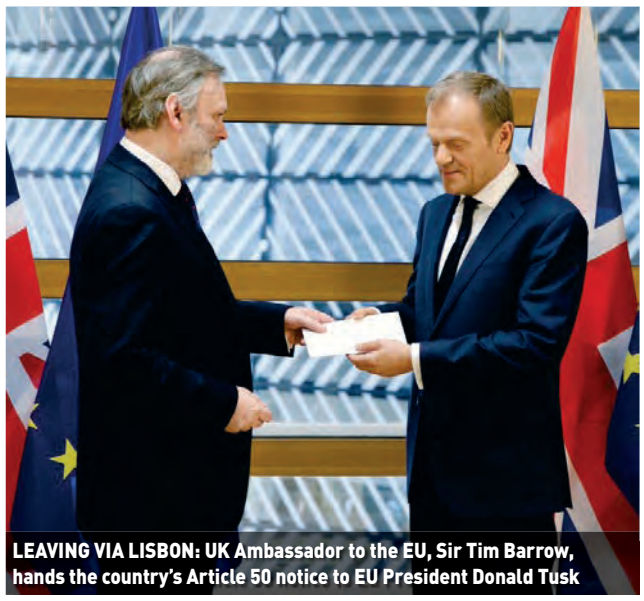
@ComRiskOnline

As the UK formally began proceedings to withdraw from the EU last month, risk managers and their transfer partners set about preparing for life after Brexit.

While the future relationship between Europe and the UK remains up in the air ahead of long and no doubt thorny negotiations, risk managers have been urged to prepare for a "cocktail of risk" but also have the opportunity to add real value to their organisations.

MAKING PLANS...

Meanwhile, insurance partners have set about making plans to ensure they can continue to serve clients across Europe when the UK quits the EU.



LEAVING VIA LISBON: UK Ambassador to the EU, Sir Tim Barrow, hands the country's Article 50 notice to EU President Donald Tusk

Late last month, UK Prime Minister Theresa May triggered Article 50 of the Lisbon Treaty. It marks the start of a complex two-year negotiation on the country's exit from the EU. Noises coming from the UK government suggest it will seek a 'hard' Brexit, in which the country will exit the European single market. Any new trading relationship will only become apparent as negotiations progress, but the EU has made clear it will not offer the UK the same terms it currently enjoys.

According to Russell Group, corporate risk managers face opportunity and huge risks in the period of uncertainty caused by the UK's withdrawal from the EU. It said risk managers must prove their worth.

The company said risk managers have an opportunity to add value to boardroom discussions about the impact of Brexit and address the risks facing their business.

...FOR NIGEL

In particular, political risk analysis and data sharing will help assess the potential impact on corporate operations and "create a protective shield against the risks from Brexit", said the risk management services firm.

"Over the next two (or potentially longer) years, the renegotiation process mixes a cocktail of risks that threatens to intoxicate and destabilise normally sober corporate risk managers," Russell Group said.

BREXIT: p22

AIG leadership vows to resist carve up and stick to plan post-Hancock

◇ AIG

Adrian Ladbury
aladbury@commercialriskonline.com

@ComRiskOnline

AIG's incumbent leadership will continue to resist any further efforts to break up the group, according to comments made by non-executive chairman Douglas Steenland and outgoing CEO Peter Hancock in the firm's recently published annual report.

AIG management has been under pressure from activist shareholders to split the company in order to lose its designation as a Systemically Important Financial Institution (SIFI) and thus reduce capital requirements.

In his final letter to shareholders, Mr Hancock, who announced he will leave AIG last month, admitted that the company had reacted too slowly to "recognise the depth of issues" within its US casualty business. This ultimately led to a massive $5.6bn reserving addition in the fourth quarter of 2016, wrecked AIG's annual results and caused Mr Hancock's resignation.

STRATEGIC DECISION

But Mr Hancock defiantly stated that he believes the remedial actions to shed poor performing casualty business, purchase a huge adverse development cover (ADC) with Berkshire Hathaway, cut costs and return billions of dollars of capital to shareholders – rather than breaking up the group as suggested by activist investor Carl Icahn – is the right strategy.

Mr Hancock took the opportunity to remind shareholders of the perilous position that AIG found itself in when he was hired by former CEO Bob Benmosche in 2010. Mr Hancock pointed out that after taking over in September 2014, he leaves AIG in far better shape.

"When my predecessor, Bob Benmosche, recruited me to AIG in early 2010, the company was still reeling from the financial crisis. Strategic priorities were centered on three areas: (i) de-risking AIG's balance sheet, including unwinding nearly one trillion dollars of complex derivatives; (ii) retaining customers and talent to preserve our franchises; and (iii) paying back the US government and returning quickly to market ownership. Few expected AIG to survive, let alone deliver nearly a $23bn profit to America," he wrote.

CRASH COURSE

"Four years after repaying the government, AIG has completed another significant step in the transformation on which Bob and I embarked. Over the course of 2016, our

AIG: p22

INSIDE–

Airmic raises concern over broker conflicts of interest

◇ BROKERS

Ben Norris
bnorris@commercialriskonline.com

@ComRiskOnline

Airmic has raised concern over broker conflict of interest and remuneration, calling for more transparency over how intermediaries operate and are paid.

In a new report, Airmic urges buyers to ensure they better understand how their brokers are paid and asks the market to work with members to allay their fears.

The association flags potential conflicts of interest over broker remuneration, highlighting insurance services brokerage (ISB), the use of facilities and broker relationships with certain insurers as key areas of concern.

The association wants buyers, brokers and insurers to work together to ensure its members get to see the full picture and have peace of mind when dealing with intermediaries.

The report focuses on the remuneration of brokers by insurers. Commission at the policy level is not considered because Airmic members report this is clearly disclosed. The paper, entitled *Commercial Insurance Intermediaries – Transparency, Disclosure and Conflicts of Interest*, focuses on broker remuneration in the large commercial insurance market, noting that alternative arrangements may be in place for intermediaries operating within the SME space.

The report explains that there is rising concern among Airmic members over broker remuneration agreements. Broker conflict of interest and remuneration models constituted a top three concern in Airmic's latest member survey. The association explained that members are unclear about the growing range of services provided by brokers to insurers and how they are paid for this work.

The report – which is based on discussions with buyers, brokers and insurers – notes that as brokers look to deliver more on relatively static income from clients, there has been a shift towards increased remuneration from insurers.

"Throughout these changes, Airmic members expect complete transparency from brokers, as this is key to retaining and building trust with buyers," the report explains. It stresses that buyers are entitled to full information about the relationships between brokers and insurers.

Airmic's report says the potential for conflicts of interest in contingent commissions is clear and therefore the practice has been discontinued by most major intermediaries across their entire portfolio.

SEEK CLARITY

The association says although there have been a few limited examples of the return of contingent commissions in some geographies or classes of business, it is unaware of such arrangements in the market used by their members. Insurance buyers are still advised to clarify whether arrangements of this kind apply to any of their placed risks.

However, Airmic is concerned about payments brokers receive for ISB. Airmic members report that remuneration for ISB, which is essentially a work transfer fee for administration and distribution costs paid by insurers to brokers, is not clearly marked separately from the overall commission received.

It stresses that insurance buyers should be clear about the amount of ISB charged on each line of business their intermediary has placed, and to which administrative services this relates.

For example, the fee could be for developing the contract wording. Airmic says that because the insurer is paying this fee, "there may be a potential conflict in terms of whose best interest is placed at the heart of the contract". Insurance buyers wish to understand how such conflicts are managed, notes Airmic.

Intermediaries can also charge insurers alternative work transfer charges for other services such as claims management.

Insurance buyers should understand where intermediaries receive ISB or alternative work charges on their placements and clarify the services undertaken, says Airmic.

"This can be compared against the scope of services that the intermediary presents to the insurance buyer in order to clarify where the intermediary is acting for the insurer, and where the intermediary is acting on behalf or the buyer," it adds.

Insurance buyers can ask for ISB to be specifically identified on a separate line on the slip and on the remuneration statement, states Airmic in its report.

Growing use of commoditised market facilities, through which brokers earn additional remuneration and insurers benefit from lower operating costs, is flagged as another potential area of conflict in the report. Airmic is "encouraging members to ensure they understand how insurers are selected and how the facility is tested against the open market".

Although the benefits of facilities are largely clear for the buyer, particularly where the facility is risk or industry specific, there is potential for conflict of interest that must be addressed to avoid insurance buyers being "influenced towards facilities", states Airmic.

"Additionally, the underwriting authority given to the intermediary can also lead to pricing conflicts of interest, unless carefully managed. Buyers should be aware of the alternative market solutions and request that these are fully considered. Buyers should also be clear on whether intermediaries have a financial interest in the facility, based on underwriting profitability or claims experience," it adds.

Georgina Oakes, Airmic's research and development manager and one of the authors of the report, commented: "It's really important that risk managers equip themselves with knowledge of what products other insurers offer that rival the facilities they are being recommended. They should make sure that these markets are being considered by their broker too and if not, why not."

Airmic's report stresses that enhanced commissions relating to risk placement in a facility should be disclosed to the insurance buyer.

Buyers "should ensure that the percentage commission and the value this amounts to are clearly highlighted on the remuneration disclosure documents provided by intermediaries", it continues. Buyers can also ask if the facility requires an upfront fee from insurers, the report adds.

STRATEGIC POSITION

Strategic agreements between brokers and certain insurers is another concern raised in Airmic's report.

The fees associated with portfolio services are typically not explicitly linked to volume of business or any individual client account.

However, Airmic members have suggested that there may be an implicit link between the fee paid and the volume of business controlled by the intermediary.

The nature of these relationships has the potential to create an "unconscious bias towards the insurers that the intermediary has agreements with over those that it doesn't, unless managed carefully", warns Airmic.

Buyers should understand which insurers their intermediary has strategic relationships with and what services are provided, says the association. They should also be aware of other insurers in the market that may well have products and services of interest and relevance to the insured, but about which the broker may be less familiar.

"This assessment should ideally take place several months before renewal to avoid the issue of offers only being made a few days before cover is provided, and preventing the insurance buyer from considering alternative options," states Airmic.

"Brokers are unlikely, nor are they necessarily obliged, to share details on the sums of money paid by insurers for these relationships. We believe insurance buyers should identify which insurers their broker has these relationships with and – perhaps most importantly – which insurers their broker doesn't have these relationships with," commented Ms Oakes.

Airmic is simply asking for transparency over all of these potential conflicts of interest and stresses that it has not taken a view on what business models brokers should or should not use.

"What we care about is whether our members have the full picture to help them understand where the risks of potential conflicts of interest might lie and how these are being managed," said John Hurrell, Airmic CEO.

As well as calling on buyers to carry out due diligence on broker models and remuneration, Airmic wants all parties to work together to ensure its members get full disclosure.

"It is in the interest of all parties that insurance buyers feel comfortable both with their brokers' remuneration methods and how they are communicated, and we are therefore confident that the market can work together to ensure complete openness at all stages of the buying process," added Mr Hurrell.

Cambridge University is building extreme risk model for large corporates

◇ University seeks corporate partners to develop threat tool

◇ ACADEMIA

Stuart Collins
scollins@commercialriskonline.com

@ComRiskOnline

THE CAMBRIDGE Centre for Risk Studies (CCRS) is developing a global risk modelling tool to help corporates better understand the potential impact of extreme events such as natural catastrophes, disease outbreaks and political unrest.

CCRS, which is part of the University of Cambridge Judge Business School, has started this process by developing a corporate version of its Global Risks Index, previously known as the Lloyd's City Index.

INDUSTRY

It is currently looking for large corporates to help develop a prototype global risk modelling solution.

Late last year, CCRS published the latest findings from its Global Risk Index, which calculates potential losses as a percentage of GDP for rare and unlikely events. It concluded that the expected loss of GDP from a range of shocks is trending upwards, driven by economic growth and increasing geopolitical risk.

The Global Risk Index is part of Project Pandora, a risk research programme supported by members of the insurance industry including AIG, Lloyd's, Munich Re, XL Catlin and Willis Towers Watson.

According to Professor Daniel Ralph, academic director at CCRS, the corporate world could learn from insurers that take an almost unique approach to catastrophic risk.

"The insurance industry is relatively advanced when it comes to managing extreme events and resilience. More industries should consider their exposure to extreme risk events and not just the ones on their books, but also external events like war, pandemics, sovereign default or a major power outage," he said.

The insurance industry has developed models and scenario tools to assess its ability to withstand extreme events. These scenarios were initially focused on natural catastrophes, including hurricanes and earthquakes, but have been expanded to include financial crises and new areas like cyber and political risks.

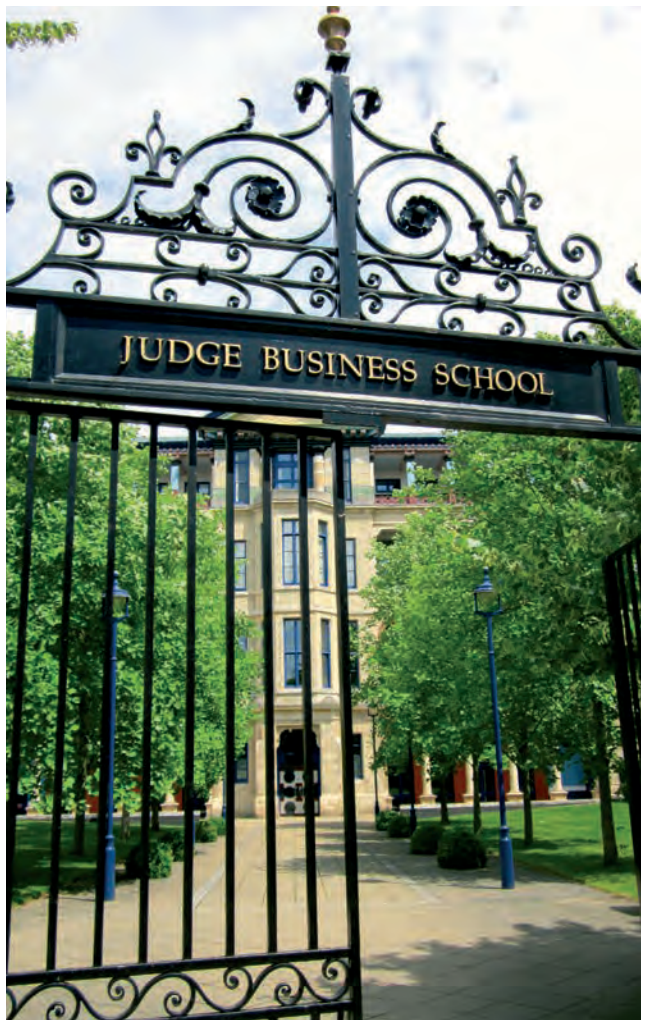
The Global Risk Index models 12,000 scenarios across 22 threat types and 300 of the world's most economically important cities. CCRS continues to develop the models and data layers in the index. It also wants to make the tool more relevant to corporates, explained Dr Ralph.

"The next phase of Project Pandora will see the Global Risk Index move away from a pure economic and city view of risk to include a corporate and supply chain perspective," he said.

Of all the risks on a corporate risk register, some 30% to 60% could be understood through the lens of external threats, estimated Dr Ralph.

"It should be possible to identify which extreme and catastrophe events are most relevant for a given organisation in terms of impact and likelihood, which would assist management in risk mitigation decisions and provide a more quantitative approach to risk disclosure," he told *Commercial Risk Europe*.

With changes in the operating landscape, such as increased connectivity and rapid pace of change, risk has been rising up the corporate agenda. At the same time, risk governance is evolving and boards are being asked to consider the principle risks to their organisations.



The Cambridge Centre for Risk Studies at the Judge Business School

QUANTITATIVE

"Risk disclosure is often well meaning but is too often vague and lacking in quantitative meaning. We think that we can help companies understand their exposures to large events by providing some quantitative estimates for them," said Dr Ralph.

For large companies the risk register should be more than just a talking point, he continued. Dr Ralph predicted that large corporates will increasingly want to put some numbers to these top risks.

This may already be possible in areas like pension fund risk, where data is readily available. But Dr Ralph thinks that progress can now also be made in areas like political risks, pandemics and natural catastrophes.

Eventually, companies should be better able to compare the risks versus the return of operating in different markets and geographies, and stress-test business plans against certain scenarios, he said.

CCRS is close to being able to map corporate operations by geography, particularly for industries like manufacturing where it can track physical assets, infrastructure and markets. The next step would be to overlap this corporate model with the threats, said Dr Ralph.

"We are updating and revising our cities work and [we] are moving beyond a GDP loss view toward a corporate footprint view and business metrics for loss," he explained.

"We have already shown that we can compare threats to GDP at a city level, now we are working towards the point where we will be able to demonstrate this at a corporate level," he said.

This could result in an analytics tool that large corporates can customise and populate with their own data, and then map against CCRS threat data.

The tool could be used by large corporates to rank their largest external risks. It could also quantify the size of the shock that is most relevant to boards and shareholders, such as the potential impact on earnings or a company's ability to pay a dividend, explained Dr Ralph.

PROTOTYPE

CCRS is looking to develop a prototype tool and then wants to work with two or three "pioneering" corporate partners to produce a working model. Potentially, CCRS could be ready to move to "production level" for a consortium of corporates within three years.

Dr Ralph sees the development of a corporate threat model as complementary to growing interest in risk.

"More and more companies find this topic has a lot of resonance. The hunger for this type of tool is growing and I am confident we can make an impact," he said.

THE TEAM

EDITORIAL

DIRECTOR
Adrian Ladbury
aladbury@commercialriskonline.com

DEPUTY EDITOR
Ben Norris
bnorris@commercialriskonline.com

LEGAL EDITOR
Liz Booth
lbooth@commercialriskonline.com

REPORTERS
Rodrigo Amaral
ramaral@commercialriskonline.com

Garry Booth
gbooth@commercialriskonline.com

Stuart Collins
scollins@commercialriskonline.com

Tony Dowding
tdowding@commercialriskonline.com

Sarah Jolly
sjolly@commercialriskonline.com

Nicholas Pratt
npratt@commercialriskonline.com

DESIGN & PRODUCTION

ART DIRECTOR
Alan Booth
abooth@commercialriskonline.com

PRODUCTION EDITOR
Chris Morrish
cmorrish@commercialriskonline.com

COMMERCIAL

DIRECTOR
Stewart Brown
sbrown@commercialriskonline.com
Tel: +44 203 858 0190

DIRECTOR
Hugo Foster
hfoster@commercialriskonline.com
Tel: +44 203 858 0191

GROUP OPERATIONS MANAGER
Annabel White
awhite@commercialriskonline.com
Tel: +44 203 858 0193

EMAIL ADDRESSES

Editorial
news@commercialriskonline.com

Sales
sales@commercialriskonline.com

Events
events@commercialriskonline.com

Subscriptions
subs@commercialriskonline.com

General Enquiries
enquiries@commercialriskonline.com

SWITCHBOARD

Tel: +44 203 858 0192

ADDRESS
Rubicon Media Ltd, Unit 5,
Parsonage Farm Business Centre,
Ticehurst, East Sussex, TN5 7DL, UK

PRINTING
Warners (Midlands) plc

MAILING AGENT
Action Mailing Services Ltd.

EXECUTIVE DIRECTORS
Stewart Brown, Hugo Foster, Adrian Ladbury

Commercial Risk Europe CR

Insurance & Risk Management News

COMMENT

Broker remuneration: Let's sort it out this time!

THE THORNY TOPIC OF BROKER remuneration raised its ugly head again last month and we have to say this has been coming for quite a while now.

Airmic, the UK risk management association, brought the topic to the fore in March via a report that reveals rising levels of concern among its members about the way in which brokers are paid.

The association flags potential conflicts of interest over broker remuneration, highlighting insurance services brokerage (ISB), the use of facilities and broker relationships with certain insurers as key areas of concern [*see related article on page three*].

Airmic advises risk managers to take a more proactive approach to understanding the potential for conflicts of interest in the business models adopted by their brokers. The association warns that the increasing scale and complexity of broker market remuneration agreements has led to rising concern among its membership.

This should come as no surprise to anyone.

Broker remuneration was previously a big issue when former New York Attorney General Eliot Spitzer led an attack on contingent commission back in 2004 that ultimately led to the departure of former AIG chief Hank Greeneberg, and was, in reality, never adequately concluded.

There was lots of noise, accusations thrown around and lawsuits pursued, particularly in the US, but the contingent deals were never banned. Ferma attempted to clean up the European market and the European Commission (EC) became involved.

But at the end of the day, the whole matter of broker remuneration and conflict of interest was only partially dealt with.

So why has this sensitive topic emerged again to grab the headlines?

One big reason is that the economics of the commercial and corporate insurance sector have changed and put all players – risk managers, brokers, insurers and reinsurers – under pressure.

The market has been soft for a long time and shows no sign of hardening across the board. Static premium volumes in core mature markets are making it difficult for insurers and brokers to post the profits that investors demand.

It is increasingly difficult for international carriers and brokers to supplement flat premiums in core markets with rising premiums in emerging territories.

Investment returns and the overall outlook are not helping of course.

As Dr Christian Hinsch, CEO of HDI Global, clearly states in our Hot Seat interview, there is only one sensible route for carriers to take in this environment. They must pursue firm underwriting and be willing to lose volume for the sake of underwriting profit.

This puts brokers in a difficult position. They have reacted by adopting dual wholesale and retail broking operations, which effectively compete with themselves, and created facilities, especially in the London specialty market.

These facilities and the rising number of managing general agencies make sense for the insurers that hand over their capacity. It is a cost-effective way of generating income. For the brokers that have the scale and skill needed to make these work, it generates badly needed revenue too.

Don't forget that the big reinsurers have been aggressively expanding down into the primary market in a variety of ways, effectively competing with their core historic reinsurance customers.

And it is looking increasingly likely that the billions of dollars of capital markets capacity waiting in the wings will also invade the primary market via the range of intermediary facilities, including SPVs and the ILS market.

One could argue, of course, that this is simply a logical response to the rise of new technologies and changing customer demand. It shows how effectively this market, not least London, is evolving. This is free market adaption to how risk capital is brought to bear.

But unfortunately, all of this adds up to one very obvious conclusion: once again, the regulation that governs this market and other parts of the financial services sector is no longer fit for purpose.

It doesn't address conflicts of interest as the lines between the risk carrying and distributing markets become increasingly blurred.

The EC made it absolutely clear in discussions over the renewal of the Bloc Exemption that it believes the commercial and corporate insurance market could, and should, be able to sort out its own potential conflicts. But this approach could change with the arrival of a new Eliot Spitzer. As the UK Brexit vote and arrival of Donald Trump in the White House clearly demonstrate, politics can change very quickly.

Therefore, the European and US risk management community needs to take the matter of broker remuneration very seriously indeed and find a solution before regulators feel the need to act.

The International Federation of Risk and Insurance Management Associations will meet at Rims later this month in Philadelphia. It would be great to hear that broker remuneration and wider market regulation is on the agenda, and that the various representative bodies agree to tackle the issue collectively with vigour.

Commercial Risk Europe and our sister titles will not let this matter be swept under the carpet again. We urge our readers to actively take part in this important discussion and help find some real solutions this time.

US casualty market to soften despite AIG troubles

◇ US MARKET

Stuart Collins
scollins@commercialriskonline.com

@COMRISKONLINE

SOFTENING US CASUALTY INSURANCE market conditions looks set to continue, despite massive reserve additions at AIG.

In February, AIG posted an $849m loss for 2016 after adding $5.6bn to its reserves in the fourth quarter, caused by an increase in frequency and severity of US casualty claims. The insurer has drastically reduced its US casualty business, cutting premium volume by 60% since 2011.

AIG's experience will have left some insurance buyers wondering if industry-wide rate increases are on the horizon. Not so, according to Stephen Kempsey, US casualty practice leader at Marsh.

Buyers of US casualty insurance can expect to see continuing strong competition and ample capacity for most casualty lines in 2017, Mr Kempsey told *Commercial Risk Europe*.

Rates for workers' compensation insurance and general liability continued to fall in the fourth quarter of 2016, while umbrella/excess liability rates were generally flat, according to Marsh's most recent quarterly casualty report. The one exception was motor liability, which remains the most challenging primary casualty line.

DECREASES SLOW

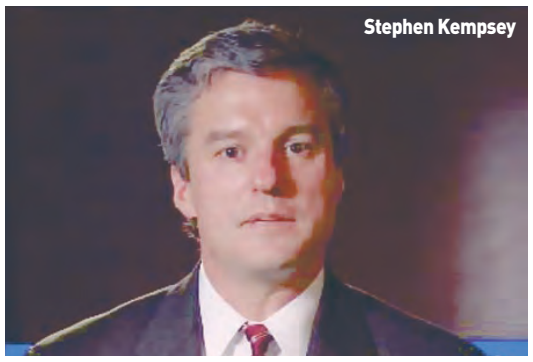
Further softening of US casualty business is likely in 2017, but the rate of decreases has been slowing, explained Mr Kempsey. "General liability and workers' compensation continue to soften but at a decreasing rate," he said.

Little, if anything, has changed in the US casualty market as a result of the reserve increases at AIG, according to Mr Kempsey. Where AIG has scaled back, other carriers have taken up the slack, he said.

"While some insurers have pulled back, many are hungry for US casualty business and continue to expand. We have had no problem placing run-of-the-mill liability business in the US," he told CRE.

Insurers in Bermuda and London have shown an increased appetite for US casualty business, said Mr Kempsey. For example, Marsh created a new US casualty facility in 2016, backed by Bermudian insurers. London market insurers have increased their participation in syndicated programmes for US casualty risks, said Mr Kempsey.

This additional capacity has helped keep price increases at bay. "Underwriting results may be deteriorating but we have seen new


Stephen Kempsey

capacity and players expand into new lines, and this will keep prices in check," said Mr Kempsey.

While AIG had to increase reserves for US casualty in the fourth quarter, few other insurers have yet to do so outside of US motor.

"AIG has been vocal on seeing increased frequency and severity in US casualty, but we have not heard this consistently from other carriers," said Michael Lagomarsino, senior director at AM Best in Oldwick, New Jersey. "Although we have heard that some are strengthening US casualty reserves outside US auto," he added.

Loss trends are an area to watch, especially given the soft market and high levels of competition, according to Mr Lagomarsino.

"As a long-tail line, casualty is more exposed to changes in loss cost and inflation, and if there was a change then the position of a number of US insurers could be significantly impacted," he said.

Asked if recent reserve additions are confined to AIG and, to a lesser extent, a few other companies, Mr Lagomarsino said: "Only time will tell. For now, this seems to be a company-specific issue, but we are cautious and are watching to see if it leads to anything more broad-based."

But like Mr Kempsey, Mr Lagomarsino does not think the recent experience at AIG will trigger a change in the market.

"The commercial lines industry is awash with capital, so I don't think what we have seen with AIG will impact the industry in terms of rates. At least not immediately," he said.

US casualty sector performance does appear to be deteriorating on an accident year and, increasingly, calendar year basis, according to David Flandro, global head of analytics at JLT Re.

US casualty lines – excluding motor and workers' compensation – have reported a combined ratio in excess of 100% for the past five years, and are projected to produce a combined ratio of 106.2% in 2017. Workers' compensation has fared better and is predicted to see a combined ratio of 94.6% in 2016 and 96% in 2017, according to AM Best.

"Workers' compensation has performed admirably over the past five years, driven by increased payroll and reduced frequency. Medical costs remain a concern but these have moderated more recently," said Mr Lagomarsino.

Calendar year reserves have showed consistently lower reserve releases and are likely to post net deficiencies in 2017 or 2018, according to Mr Flandro.

AM Best estimates that the US industry's property/casualty total reserve deficiency stood at $49bn for the year-end 2016 – $3.2bn weaker than 2015. Workers' compensation showed the largest overall deficiencies at $22.1bn.

"In aggregate, we see some weakening of US casualty reserves, including workers' compensation and other/products liability. But most US commercial lines companies' balance sheets are able to absorb a modest amount of reserve deficiencies," said Mr Lagomarsino.

However, insurers could experience inadequate or weakened reserves if they fail to respond to emerging loss trends with rate adjustments or corrective underwriting actions, AM Best states in its recent US Property/Casualty report.

In general, deficiencies in casualty and long-tail reserves are usually a necessary pre-condition for a sustained market turn, according to Mr Flandro.

"We estimate that the liability crisis, which affected accident years 1998 to 2002, cost the insurance sector hundreds of billions of US dollars of capital, far bigger than any one catastrophe. If reserves become obviously deficient, the entire presumption of excess capital in the sector will be challenged," he said.

Large reserve increases for US casualty business in the late 1990s and early 2000s – led by big players like AIG and Zurich – were followed by significant rate increases to repair balance sheets. Some buyers will, therefore, wonder if the ingredients are there for a repeat of the casualty crisis of the late 1990s.

Despite some parallels with today – both AIG and Zurich have seen negative developments on US casualty reserves in recent years – this currently seems unlikely.

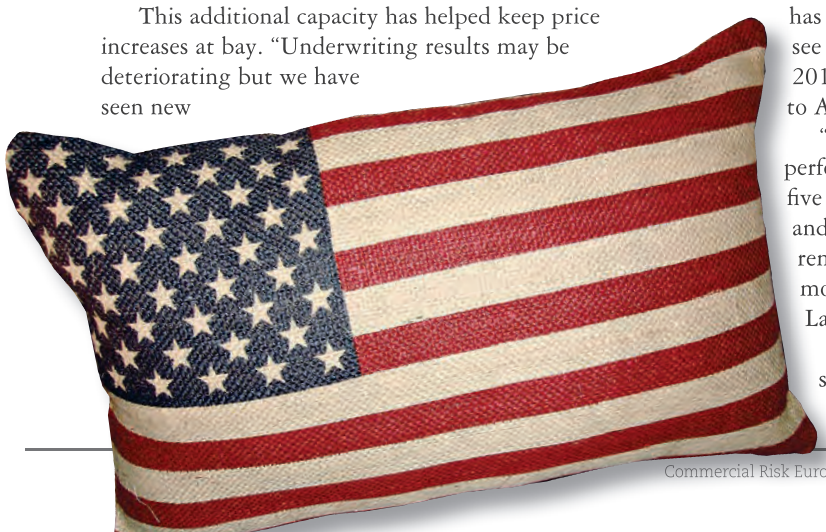
GROUNDHOG DAY

"History can repeat itself. But where we sit today, loss costs over the past five to ten years have been benign, inflation is low and interest rates are low – which has forced insurers to focus on underwriting. It's very different from the late 1990s and early 2000s," explained Mr Lagomarsino.

"There have also been some fundamental changes in the US property/casualty industry. We see enhanced risk management, greater use of modelling and better governance and controls. Which all makes companies more thoughtful and puts them in a better position to respond more quickly to changes in the market," he added.

Despite a softening market, underwriting discipline has largely held up, according to Mr Kempsey. For example, insurers now commonly apply cyber exclusions to casualty lines as they look to manage their risk, he said.

In addition, certain lines of business, such as workers' compensation in Florida where the state courts have ruled some aspects of the law unconstitutional, remain more competitive. General liability risk with wildfire exposures in states like California, as well as general liability cover for New York construction, are also harder to place, explained Mr Kempsey.



London bids to improve claims handling in subscription market

◇ SUBSCRIPTION

Rodrigo Amaral
ramaral @commercialriskonline.com

@COMRISKONLINE

KEY UNDERWRITING groups in the London market have approved a Single Claims Agreement model proposed by brokers, which will allow lead carriers to authorise non-complex claims up to a specified value on behalf of all followers in the subscription market.

Both the International Underwriting Association (IUA) and the London Market Association (LMA) have given the green light to the model, which will be used by both London company market and Lloyd's underwriters.

SPEED CLAUSE

The proposals would see a clause inserted into insurance contracts in which both LMA and IUA members participate. The clause is expected to make clear that participants in the contract delegate decision-making powers on small,

non-complex claims to a lead insurer.

"This is the future and it will lead to benefits for consumers, and it should mean faster decisions," said Hannah Purves, claims director at Markel International.

Currently, Lloyd's and London company market underwriters use different claims protocols. At Lloyd's, lead syndicates make decisions on standard claims below £250,000, while in the London company market, carriers have agreement rights to their share of the claim.

Under the new proposal, underwriters would agree to use the single claims approach at point of placement for individual insurance policies. Dave Matcham, CEO of the IUA, said such an approach would make the claims process in the London market "faster, cheaper and more effective".

The new approach will not cover large claims, although its threshold could be higher for certain lines, such as energy, sources say.

"The primary feature of this change will be a streamlined process to handle non-complex claims," said Andrew Shütte, a partner at law firm Hill Dickinson.

With the support of London's underwriting community, the single claims agreement can now be finalised and introduced to the underwriting and claims process, said the London & International Insurance Brokers' Association (LIIBA).

But negotiations will have to overcome a number of hurdles. Mr Shütte noted, for instance, that insurers will want contractual guarantees that any insurer given delegated authority to make a claim decision has the technical ability to do so. This could lead to a concentration of claims handling expertise at a few insurers, he suggested.

There is also the matter of the new UK Enterprise Act, which will kick off in May. It places a stronger duty on insurers to deal with claims in a reasonable time. The harsher punishments imposed by the Act could make insurers more reluctant to relinquish decision-making power over claims to other firms, Mr Shütte said.

The new system will also have to meet requirements of the various regulators involved. IT systems at participating insurers will also need to be harmonised.

The new system will be voluntary and will include "soft triggers" to allow participants to opt out of the protocol in certain circumstances. But the London market believes the system will boost its appeal.

"It will modernise the London market and the claims process, and it will improve buyers' experiences with low level, low complexity claims," said Lee Elliston, head of claims operations at the LMA.

He believes discussions over the protocol will be concluded this year, with the new system implemented in 2018.

MODEL AGREEMENT

Announcing the development, LIIBA said the London market can expect quick progress: "The LMA, IUA, LIIBA and Lloyd's are in agreement with the plan to deliver a single agreement model. Work is now already underway to build the necessary framework to deliver the proposed model and further details will be communicated."

Christopher Croft, LIIBA CEO, said: "The broking community is delighted that we can move forward with the Single Claims Agreement as it will expedite the handling, agreement and payment of uncontroversial, small to medium-sized losses under London subscription market placements, to the benefit of clients."

Insurers strive to improve claims process

◇ SERVICE

Rodrigo Amaral
ramaral @commercialriskonline.com

@COMRISKONLINE

AS COMPETITION becomes increasingly fierce in the insurance market, underwriters are trying to improve claims handling and service. Initiatives range from the use of technology, such as drones and improved IT, to decentralised decisions and restrictions over exactly who can deny a claim.

PORTAL

Allianz Global Corporate and Specialty (AGCS) is developing an online claims portal, which should be fully operational next year, where information can be accessed by clients.

Alexander Mack, chief claims officer at AGCS, said the new claims portal helps identify trends that can be shared with clients.

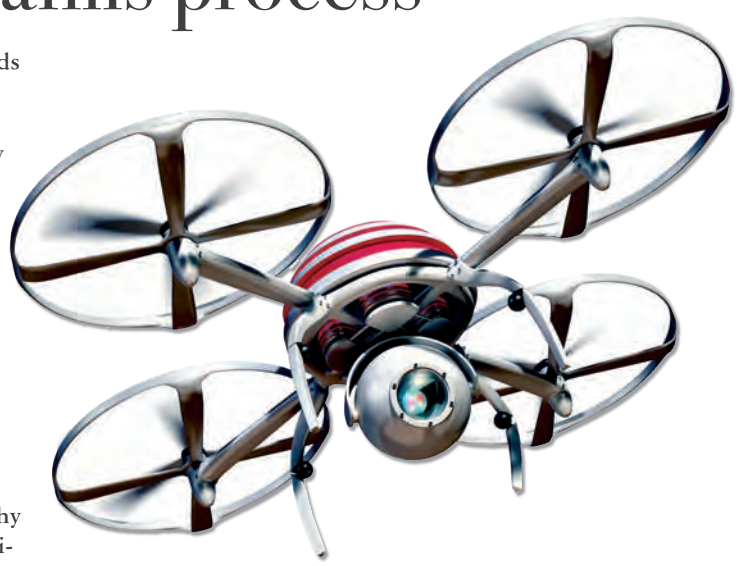
Mr Mack heads a 680-strong claims department at which several decisions have been taken in recent years to enhance the claims process. His department works in a decentralised way, with officials in local offices taking greater responsibility to settle claims. Empowering officials close to the risk is key, given the fact that the department handles more than 120,00 claims a year.

Mr Mack explained that new technologies are being implemented to deal with small, non-complex claims. This includes an app that enables insureds to stream high quality images of damage.

"These images allow claims handlers to take immediate decisions. "It will improve and speed up the payment of small losses significantly," Mr Mack said.

DRONES

He also said that AGCS is testing the use of infrared thermography in claims and has experimented with drones. Mr Mack noted, however, that the quality of images currently produced by drones is insufficient to fully replace other loss inspections. Mr Mack, who is also a member of the AGCS board, said claims handling has moved from a back office to a



strategic function in the insurance market. This view is shared by other insurers. "We see claims as much as a shop window as the underwriting side," said Hannah Purves, claims director at Markel International.

She noted that at Markel International all members of the claims handling team have the power to authorise a claim payment, while only a third can deny a claim. The idea is that the company works on the presumption that claims will be paid, she said.

The cyber risk landscape today...

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*Allianz Risk Barometer 2015 surveying over 500 risk managers and experts from 40+ countries

Allianz

Cyber preparedness and response


◇ CYBER

Helen Bourne & Mark Williamson
Partners , Clyde & Co

@ClydeCoNews

CYBER IS A WORD you no doubt read every day, such is the concern around the ever-growing and evolving problem of cyber security.

The UK government's annual *Information Security Breaches Survey* for 2016 states that 65% of large firms detected a cyber security breach or attack in the past year, with 25% of these experiencing a breach at least once a month.

The survey also found that while 69% of businesses say cyber security is a high priority for senior managers, only 51% of companies have taken recommended actions to identify cyber risk and even less have implemented cyber security policies or incident response plans.

While notification is not yet mandatory in the EU this is set to change with the upcoming General Data Protection Regulation (GDPR).

The GDPR comes into force across the EU from May 2018. Among other things, it will impose a 72-hour deadline for notifying a breach to the relevant authority and individuals where there is a high risk to their personal data. Businesses will be subject to fines of up to €20m or 4% of annual global turnover, whichever is higher, for infringements of some of the rules.

Given the near certainty of a cyber security breach or attack, and the potential financial and reputational implications, this is no longer an issue confined to the IT team; it is something that needs to be addressed at board level and requires full engagement of key decision-makers in the company.

Being prepared so that any breach can be dealt with quickly and effectively with minimal disruption is crucial to business.

Breach response is, by nature, time critical. It frequently crosses jurisdictions and industry sectors. The first hours immediately following a breach are the most important. Trying to determine the necessary steps to take once a breach has occurred potentially results in delays and the likelihood of greater loss.

Each organisation requires an incident response plan tailor-made to meet its individual needs and resources. Below is a non-exhaustive list of considerations companies should bear in mind:

EVALUATE AND PREVENT:

- Conduct an IT risk assessment using data and network mapping to determine what data, intangible assets and devices your business holds and their value. It is also important to gather threat intelligence on a regular basis. Any gaps in protection, IT or otherwise, should be remedied as necessary.
- If not already in place, consider the need for the development of internal cyber security policies and procedures addressing, among other things, key security controls, the process for reporting breaches, remote rules, controls around using personal devices and social media use.
- Know your data protection and legal obligations.

PLAN:

- Engage with the board and seek authorisation for the development of cyber security protocols, necessary resourcing and a budget for implementation.
- Set up an incident response team (with backups) formed of members across the business functions. Ideally, the team would consist of members from risk management, IT, legal, PR, human resources and the board. Increasingly, companies are looking to specifically appoint a chief information security officer who will, as part of their responsibilities, act as the team leader in the event of a breach.
- Draft a clear data breach incident response plan that will be initiated when a breach occurs, whereby the pre-approved incident response team will be alerted and follow clear protocols to remedy the breach, minimise loss and preserve evidence.

IMPLEMENT:

- It is vital to scenario-test the incident response plan at the outset and at regular intervals, ideally by having security drills where the plan is put into action as if a breach was happening. Any flaws with the plan can then be identified and remedied.
- Distribute company policies on cyber security and response to all personnel.
- Regularly update all documents as necessary.

TRAIN:

- Mandatory training of personnel should be given at regular intervals, updated to reflect changes in any company policies or the incident response plan.
- Clear employee reporting channels should be set up and communicated.

A data breach, whether from a cyber intrusion or the loss of a device, can be challenging for any business to deal with. However, in tandem with adequate IT security, the best defence is to be prepared so that the response can be quick and effective.

◇ **LEGAL EYE:** THE BRIEFS

VW faces yet more legal challenges

◇ MORE THAN 35,000 MOTORISTS HAVE JOINED a class action lawsuit against Volkswagen (VW) in England and Wales following the emissions scandal, reported *The Guardian* newspaper.

According to the report, the number of owners involved in the class action is increasing at a rate of 500 drivers a day. Lawyers are confident the legal action will eventually involve about 100,000 owners of VW, Audi, Skoda and Seat cars.

The action seeks compensation from VW for selling cars that the lawyers argue were not roadworthy because the emissions were far higher than purported. In March, the German carmaker pleaded guilty to all criminal charges in the US over emissions cheating, admitting to a scheme that sidestepped pollution rules on nearly 600,000 vehicles. The firm agreed to pay $4.3bn in civil and criminal penalties as a result.

Fiat Chrysler investigated in France

◇ **FRENCH INVESTIGATING MAGISTRATES will open a probe into carmaker Fiat Chrysler for suspected diesel emissions tests cheating, according to reports from AFP World News.**

The investigation follows a recommendation from the French anti-fraud office and will be run by public health magistrates. France is already investigating Volkswagen and French manufacturer Renault for allegedly fitting engines with devices designed to fool emissions test equipment. US-Italian-owned Fiat Chrysler is among the world's top ten carmakers and has already been accused of emissions cheating in the US.

European Commission reinstates airline fine

◇ SAS AB has been fined €70.2m by the European Commission (EC) for breaches of air freight competition rules, according to Nordic Business Report.

SAS AB company said the Commission has revised an earlier decision and has once again fined 11 airlines for breaches of air freight competition rules. According to SAS, it will appeal the EC's decision and maintains that SAS Cargo has not participated in any global cartel. This appeal process could take several years.

Commercial Risk Europe is delighted to announce the first coverage of its 2017 European Risk Frontiers survey of leading risk and insurance managers across Europe. Sponsored by **HDI Global** and **Worldwide Broker Network**, this year's survey will look at some of the big issues facing our readers. We will tackle some of the big questions from the world of risk management and insurance buying. This time round, there is also a focus on cyber risk and transfer as this issue climbs to the very top of the corporate agenda

PORTUGAL

◇ EUROPEAN RISK FRONTIERS: **PORTUGAL**

Rodrigo Amaral
ramaral@commercialriskonline.com | @ComRiskOnline

THE 2017 EUROPEAN RISK FRONTIERS SURVEY IS BASED ON A SERIES OF ROUNDTABLE discussions and in-depth one-to-one interviews with corporate risk managers across Europe, with national reports appearing in our monthly newspaper. We will publish the pan-European report at the Ferma seminar in Monte Carlo this October.

We highly value this opportunity to speak directly with our core readers, appreciate their contribution and hope you find their feedback enlightening and helpful.

We kick off proceedings in Portugal, where participants said they are in favour of the annual renewal process and want it to stay. They also discuss the leading risks facing Portuguese firms – such as competition and geopolitical issues – and how they are in turn driving risk management. The risk managers also explained that cyber risk transfer is now piquing their interest but that doubts persist about coverage. *Rodrigo Amaral* reports from Lisbon.

CONTINUED ON NEXT PAGE

Keep the renewal annual, say Portuguese

THE ANNUAL INSURANCE RENEWAL PROCESS provides companies with valuable opportunities to evaluate their risk management systems and must not be scrapped, argued risk managers participating in the Portugal leg of this year's European Risk Frontiers survey.

They also warned against initiatives to standardise insurance coverages through excessive use of underwriting models and IT systems.

INNOVATION

"In our business, we have to be constantly thinking about innovation. We think all the time about new products, new models, new risks to cover or not," said Luis Campilho, insurance manager at engineering services company Efacec. "We are analysing whether to purchase cyber risk insurance, and political risks are another coverage we are looking into, as it could be optimised for some specific situations.

"There are plenty of new situations that we have to deal with every year and as a result, renewals do not feel redundant at all.

"Renewals are repetitive but, as the cycle of life, they are necessary," said Pedro Nazaré, director of general services at Infraestruturas de Portugal, which manages the country's rail network. "Each renewal entails a re-evaluation of exposures and transfer solutions, which allows the company to keep up with the evolution of its risk profile and also to consult several insurance market partners, which can lead to the updating of solutions and rates."

"Companies need to adapt to a constantly changing world and as a result, our exposure to risks varies too," agreed António Cândido, chief risk officer at Efacec. "Every year we need to reassess our exposures and coverages, and to make the adjustments required. Annual renewals are part of this necessary process."

The annual renewal process is a time- and resources-consuming exercise that can keep risk managers awake at night as deadlines loom. But the advantages of thoroughly discussing exposures with underwriters continue to outweigh the costs, agreed the Portuguese participants in this survey. However, it is always possible to change the process and make it less taxing, they said.

"Two years ago, we started to implement a new system for our renewals," said Rufino Ribeiro, risk manager at the oil and gas group Galp. "We now promote an annual meeting in London with all insurers that we work with, in all segments. This year, almost 90 insurance and reinsurance professionals attended the meeting. Previously, we used to meet with each and every underwriter individually. We had eight or nine meetings a day, always saying the same things."

FEEDBACK

Mr Rufino values the feedback that he gets from insurance partners and believes that the renewal process is important to properly meet his company's particular needs. Not surprisingly he warned against initiatives to homogenise corporate coverages through ever more intensive use of statistical models and algorithms.

"I hope that new technologies will not turn insurance into a standardised market. If that is the case, risk management will not be necessary anymore, and neither will insurance management," he said.

"Machines will do it all, and it will be the same thing for everybody. Insurers will only input data into models. It seems that many people are trying to do exactly that in the insurance market. I hope it never happens. It is very important for us to discuss our risks thoroughly with the market," said Mr Ribeiro.

Cyber on the menu but doubts persist over coverage

ALTHOUGH DOUBTS STILL LINGER OVER the adequacy of current cyber insurance coverages, Portuguese companies are increasingly considering transferring their exposures to the market, according to risk managers who participated in our European Risk Frontiers survey.

There are, however, still questions over how comprehensive cyber coverages are and the capacities underwriters are willing to offer.

Rufino Ribeiro, risk manager at oil and gas group Galp, said cyber business interruption cover is his priority: "I do not need a cyber insurance coverage where a technician will be sent to the company when we have some kind of trouble. My providers and technicians can do that," he said. "I need a coverage that compensates the company for the period where our sales were interrupted due to a cyber event. Consequently, we have been for a long time uninterested in cyber insurance. But new, more interesting products have started to reach the market, and some look very good."

IMPROVEMENTS

António Cândido, chief risk officer at engineering services group Efacec, believes cyber coverages have improved: "Two years ago, when we first looked at cyber insurance, along with our IT colleagues, we concluded that policies available in the market were too focused on business to consumer. Our case is different, we are a business-to-business company," he said. "But it looks as if insurers have evolved since then."

Survey participants stressed that before buying a cyber policy, companies need to thoroughly identify their exposures and sharpen internal tools to deal with cyber risks.

"The goal of a cyber assessment is not only to make a decision on the purchase of insurance. Above all, it is necessary to define our internal contingency plans for all the identified risks," Mr Ribeiro said. "We have performed an internal assessment exercise with the risk management, insurance and IT teams to do an exhaustive survey on all the cyber exposures that the company has."

Insurance market solutions should only be evaluated once the cyber risk identification stage is fully complete, he pointed out.

"We have sent our risk report to our brokers, so that we can identify what we will be able to transfer to the market or not," Mr Ribeiro said. "We have talked to some underwriters and I believe that in the end, we will have a coverage that is tailor-made for our group. But we have to check what capacity will be offered. The market is talking the good talk but it seems that capacity still is not high."

According to Mr Cândido: "Cyber risks are becoming an ever more complex issue. But first we have to deal with the problem internally, finding out where our weak spots are. The input of an insurance company that shows us the work it has done in this area with other clients would be of much help."

"We are working hard to strengthen the mechanisms with which we can deal internally with cyber security risks. But we have not reached a point yet where we can identify what we can transfer to the insurance market," said José Luis Amorim, director of risk management at Sonae group. "Cyber risks must be managed by every member of the company, as they affect information systems, staff members and the interaction between staff members and IT systems all at the same time. Risk managers must be in charge of cyber risk management, given its broadness."

He stressed that cyber risks tend to become a bigger factor for companies when new data privacy regulations come into force. New rules tend to heighten potential for reputational damage, the experts said.

"Digitalisation risks have a close link to reputation risks in our case. Loss of reputation is a major concern for us, as we depend on the trust of our customers," said Mr Amorim. "Anything that can jeopardise this relationship of trust constitutes a risk. Right now, we consider that the biggest potential for impact on the trust of our clients comes from digitalisation."

Mr Amorim added: "The forthcoming European data privacy rules are very demanding in terms of protecting personal data, but also in terms of requiring that companies are capable of proving that they have the means necessary to guarantee the safety of consumer data. We have a project fully dedicated to the enhanced data privacy rules."

There are other risks created by technological developments, Mr Cândido noted.

"The obsolescence of products is an issue for companies that work with high technology, such as ours," he said. "For example, 20 years ago a product was made with a PC using MS-DOS 3.0. If a client asked today to replace that product, it would not be possible to find the same equipment. Technical assistance, in this sense, has become a very complicated task."

COMPLEXITY

Efacec implements large infrastructure projects that require delivery and use of high technology products, along with guarantees that they will work properly for long periods of time. "In complex projects, we need to provide guarantees of performance," Mr Cândido said. "But the design of the different parts may be done by different entities. If the design of the project is not done as it was supposed to, there may be additional costs in terms of replacing equipment and other things. This is an important risk, and insurance that could help us with it would be welcome."

"The challenge with systems design is that often they are unique," he continued. "It is not evident today how it would be possible to cover this risk, as the fast pace of technological change makes it really hard to deal with. But it would be of great help if we could share this risk."

Geopolitical concerns now closer to home

GEOPOLITICAL UNCERTAINTIES ARE CASTING a cloud over the activities of Portuguese companies, according to risk managers at leading firms.

Those taking part in our European Risk Frontiers survey said geopolitical concerns are not only confined to emerging markets, where Portuguese companies have expanded activities in recent years. In fact, they are closer than ever to home, with Brexit very near the top of the list.

"The United Kingdom is an important market for us and if a hard Brexit takes place, there could be an impact on our business," said António Cândido, chief risk officer at engineering services group Efacec. "If trade tariffs go up, the ability of some continental companies to export to the UK could be hampered. It is unlikely that the impact from Brexit will be felt in 2017, but in the medium term it could have an important effect on EU-based companies."

Brexit is also worrying because it is inspiring movements in the EU that have led some to question the bloc's future survival.

"The European Union is going through a particularly difficult time, and business impacts can be huge. Brexit, for example, shows that a country can leave the EU, while, until now, all movement within the European Union had pointed to expansion, not the other way around," said José Luis Amorim, director of risk management at Sonae group.

"Some eastern European countries do not look as committed to the European project as they were after the end of the Soviet bloc. Even within the core European countries – such as France, Germany, Spain, Italy and the Netherlands – there are movements, and their consequences are very difficult to anticipate. These consequences will surely not be good. We do not know yet how bad they will turn out to be," he added.

Mr Amorim sees protectionist trends, fuelled by the Donald Trump government in the US, as a risk. "Last year's election results have created a dynamic of conflicts that could have very significant impacts on global trade," he said. "Our company has a globalisation dynamic; it is one of our main strategic goals. Some of our businesses already have a strong international presence but we want to carry on developing abroad. These trends could affect this strategic goal and this is the very definition of risk."

High levels of global uncertainty also tend to shake financial markets, thus affecting the ability of companies to expand. "Financial risks are a concern because of current global financial instability," Mr Cândido said. "The cost of credit can vary considerably depending on small external events on certain markets, and we have no control over them. We look at it very closely and it constitutes an important risk for our company."

For Portuguese firms, the challenge is more acute because the country's banking system went through very hard times in recent years, and doubts about its health have not completely dissipated. "The cost of credit for Portuguese companies remains higher than those from other European countries," Mr Cândido pointed out. "But that is something that we have to live with."

Competition in recovering economy a big risk

COMPETITION IN AN IMPROVING DOMESTIC economy is one of the key risks faced by Portuguese companies, according to participants in this year's European Risk Frontiers survey. They also warn that doubts over the strength of the economic recovery make investment decisions extremely tricky.

After slumping since 2009, the Portuguese economy showed encouraging signs of recovery in 2016. Forecasts of economic growth are increasingly optimistic. In March, Portugal's central bank upgraded its own GDP growth scenario for 2017, but the pace of expansion is set to remain modest at 1.4%.

The Portuguese economy is looking more positive for companies, noted José Luis Amorim, director of risk management at the Sonae group, which operates in retail, telecommunications and other industries.

"The Portuguese market is doing better today than one year ago," he said. "Private consumption, which is very important for us, is on the rise. Our three main businesses are retail, shopping malls and telecommunications. If consumption slows down, these businesses suffer. But consumption has improved since the 2009 crisis."

He added: "We faced tough conditions in recent years but we saw improvements in 2016, especially in discretionary retail spending, which is the segment of consumption that feels the effects of the crisis with the highest intensity. Last year, Portuguese consumers began to invest again in durable goods."

However, as Portuguese consumers still struggle financially, recovering sales are greatly linked to promotional strategies that aim to convince consumers to open their wallets once again.

"We have noted a huge increase in promotional sales," Mr Amorim said. "Portugal is today the European economy with the highest ratio of promotional sales to overall sales when it comes to food retail. People have become used to waiting for promotional sales before they make a purchase. This is something that strongly affects the profitability of the business. Last year, we increased our sales and our market share, but higher sales happened thanks to more intense promotional sales activity.

"Competition risk is therefore at the top of our agenda. We expect that competition by promotional sales will be an even stronger factor in 2017," he added.

Mr Amorim continued: "New competitors continue to get into the market…Last year, a large Spanish retailer announced that they are coming to Portugal in 2019. We are also opening new stores. Last year alone we inaugurated several new stores and we are set to make new openings in 2017. Therefore, competition is the risk that demands the most attention from management teams."

Retail is not the only sector in which competition is getting more aggressive, he said. "In telecommunications, we enjoy a leading position in the provision of TV and online content, but the market has changed a lot in recent years and we face competition from powerful companies based in France and the UK. They are investing strongly in Portugal to defend their market share and to look for growth," Mr Amorim pointed out.

Even though the Portuguese economy is starting to look better, it is too early to say that it will remain on the path to recovery. This creates problems for companies and their risk managers.

"Companies are worried today about a lack of stability to make their plans. It is hard to forecast scenarios, and companies cannot say for sure which direction their business will take," said António Negreiros Fernandes, secretary general at Portugal's risk management association Apogeris. "There is a feeling that the economy is getting a little better. Statistics still need to confirm this perception, but political discourse seems to point in that direction."

However, some of the issues that have hampered the Portuguese economy in recent years are yet to be properly sorted out, Mr Negreiros remarked. "There are still issues that need to be tackled. The debt problem is still around and rates of economic growth remain low, and we have not seen clear actions that allow us to anticipate that these problems will be solved. So, even though we believe things are getting better, we still do not know for sure that this is indeed the case," he said.

RM on the rise as threat landscape expands but work to do

MORE ATTENTION IS BEING PAID TO RISK MANAGEMENT at the largest Portuguese firms, but more progress still needs to be made down the chain.

"In our company, risk management has for a long time received special attention from the board," said António Cândido, chief risk officer at engineering services group Efacec. "When the executive board meets, risk management is one of the first topics to be discussed. Once a month, I present to the executive board a summary of our projects' status. We also make presentations to the board of directors, and the risk and financial committees periodically meet with us to get feedback on risk management that is more closely related to the operational side."

"Our board is giving ever higher priority to risk management," added Rufino Ribeiro, risk manager at oil and gas group Galp. "We restructured the risk management function two years ago and the department has been much empowered by the board, which has shown a lot of interest in better understanding both insurable and uninsurable risks."

According to António Negreiros Fernandes, secretary general at Portugal's risk management associations Apogeris, awareness about risk management is on the rise. "The current uncertainty is helping this process," he said. "We still see a certain lack of maturity, especially among small companies that suffer a lack of skills to appreciate situations and how to manage risks. But we also have in Portugal today many companies that dedicate themselves exclusively to exports. The efforts that companies are making to go through the crisis are helping to drive risk management in our country."

Mr Cândido stressed that the new emphasis on risk management is particularly beneficial when Portuguese firms look to partner with firms abroad. "Very often, when there is a tender, especially in Europe, the client wants to know how the companies applying for the contract manage their risks," he said. "When they grant a contract, they want to be sure that the project will be delivered and the capacity to deliver is linked to the management of risks. Doing risk management in a structured way is a competitive advantage is these markets. Risk management is a key trust-building factor and customers only buy products and services from those they trust."

But Mr Ribeiro noted that there is still a long way to go when it comes to the development of risk management in Portugal, although large companies such as Galp are helping to spread the gospel.

"Unfortunately, in Portugal not many companies prioritise risk management. Among suppliers and other companies in the market, it still is business as usual. Things are still often done as they have always been done," he said. "It is important that firms like ours talk about risk management and help raise awareness."

SPONSOR

Awareness key to growth in Portuguese cyber market

◇ WBN
Adrian Ladbury
aladbury@commercialriskonline.com

@ComRiskOnline

THE STARTING POINT OF ANY DISCUSSION about how to manage cyber risk within a European company needs to be the EU's forthcoming General Data Protection Regulation (GDPR).

The directive stipulates that European companies need to manage cyber risk in a structured way and demands that many firms create the position of data protection officer, if such a role does not already exist.

But, according to João Almeida-Santos, director técnico – CTO at Portugal-based broker MEDIAN-Corretores de Seguros, the local representative of Worldwide Broker Network (WBN), the management of this critical and fast-evolving risk should not be left up to one individual.

This risk is enterprise-wide and does not just involve the protection of digital customer data. This means that other senior managers need to be involved, not least human resources, Mr Almeida-Santos told *Commercial Risk Europe*.

"The genesis of most discussions on cyber risk should be the EU's General Data Protection Regulation. The EU's directive creates the figure of the data protection officer, this person is central in all data protection process. Data protection covers data in all sorts of forms, not exclusively digital data. Organisations should include data protection officers, risk managers, human resources managers and information technology managers in their data protection efforts. Risk evaluation must include the human factor," he said.


João Almeida-Santos

STRUCTURE

As with other more established risks, cyber needs to be identified, measured, managed and transferred in a structured and enterprise-wide manner. According to Mr Almeida-Santos, professional brokers have a vital role to help risk managers and their fellow managers do this. Brokers can also introduce third-party data protection expert firms to help in this role.

"Brokers should assist with the identification in each case of the areas where data protection is crucial, assist with the evaluation of each risk and find coverage broad enough for client needs. Presenting examples of cases, such as recent court sentences on bank and telecom data breaches cases, helps with the education of clients. Brokers and insurers should also partner with data protection specialists, offering together a broader level of services to clients," said Mr Almeida-Santos.

In Mr Almeida-Santos's experience, a relatively small proportion of cyber risk is actually covered by insurance in Portugal. This is mainly because most companies are adopting a "wait and see" approach to the GDPR, he said.

"Traditionally, our market tends to wake up late to new risks. The media is starting to talk about cyber and some players are pushing the subject towards the mainstream. At this stage, we imagine that 200 to 300 policies have been placed locally. In the medium term, clients will be more open to discuss these risks and the market will find more players that are prepared to insure them. The EU's General Data Protection Regulation will come into force from 25 May 2018. Until then, most clients will wait and see. The conscientious ones are, however, already preparing themselves for this new reality," he added.

There are of course still significant gaps in the coverage offered for cyber risk. One important area to consider is whether or not fines and penalties can actually be covered.

The US cyber market is more advanced than others, largely because US companies are obliged by law to report cyber or data breaches and are able to buy cover for the resultant fines and penalties. This is not the case in all countries so needs to be taken into consideration, particularly when building a global programme.

"Some international wordings include cover for fines and penalties. In Portugal, this kind of coverage is forbidden. No insurer can compensate a client for a fine or penalty. Clients when buying coverage abroad, through cover agents or others, should be aware of this limitation and about the consequences of receiving improper compensation on a claim. This can be a particular problem with clients that have multinational operations, where local laws and regulations vary between countries. That's where being part of a network like WBN can help assure that local variances are recognised and addressed," said the Portuguese broker.

The cyber insurance market is clearly improving and awareness of what is and what not covered is getting better. But more work needs to be done, particularly in the SME sector, said Mr Almeida-Santos.

COMMUNICATIONS

"There are a couple of insurers providing broad coverage and others offering minimal coverages, by which policies only indemnify damages to third parties related to data protection issues. Communication must be adjusted to market reality, in which small SMEs are the majority. Communication about cyber risks tends to focus on the cyber threats to client systems through phishing, cyber extortion and the like. However, we believe focus should be on actual data protection," he said.

Mr Almeida-Santos said cyber capacity is not a problem in the Portuguese market. But a lack of awareness over the potential of cyber risk does mean it is perceived to be expensive, he added.

"Capacity isn't a problem. Our market is composed mostly of SMEs that tend to find premiums high in most cases. Communication and education in this area will change current risk perception, consequently coverage and premiums will be better appreciated," Mr Almeida-Santos said.

Some believe that governments need to create cyber pools, such as in the areas of terrorism and natural catastrophe, to help ensure that industry is better protected from cyber risk. Mr Almeida-Santos believes this could well help foster the growth of a more vibrant cyber insurance market.

"In Portugal, we need first to conclude the terror and natural catastrophe pool, something being postponed year after year. Portugal is known for its extensive set of compulsory insurances. If authorities set cyber risk as a compulsory insurance in general, or for a pre-set number of activities, then cyber will grow very quickly," he concluded.

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Hugo Foster
Director
Commercial Risk Europe

Email: hfoster@commercialriskonline.com
Office: +44 (0)203 858 0191
Mobile: +44 (0)7894 718 724

Stewart Brown
Director
Commercial Risk Europe

Email: sbrown@commercialriskonline.com
Office: +44 (0)203 858 0190
Mobile: +44 (0)7780 998 440

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Loss prevention is foundation of cyber risk management

◇ HDI
Adrian Ladbury
aladbury@commercialriskonline.com

@ComRiskOnline

Beatriz Rodriguez Ploss, cyber insurance expert at HDI Global's branch for Spain and Portugal, believes that awareness of cyber risk is on the rise in Portugal and that appreciation of the value of insurance is rising as a result.

But more work needs to be done, particularly among the dominant Portuguese SME sector in which IT managers still have chief responsibility for this critical risk, she said. Basic loss prevention and the risk management role needs to be addressed first, said the insurer.

"Cyber risk needs to be firmly anchored in the executive management of a company. In many small and mid-sized businesses in Portugal, IT departments are responsible for this area. But this is an inadequate approach. A risk manager needs to be appointed whose remit of responsibility also includes dealing with cyber risks," said Ms Rodriguez Ploss.

So the big question for companies of all sizes is: How can these risks be managed most effectively?

CYBER SYSTEMS

"Risk managers need to identify, analyse and assess the cross-divisional cyber risks," said Ms Rodriguez Ploss. "They should also be responsible for the necessary enablers in terms of technology, organisation and human resources required to deal effectively with these risks. Ultimately, it is important to raise the awareness of every employee so that they understand the hazards that come from internet attacks," she added.

Not surprisingly, the Portuguese insurance market has woken up to the growth opportunity offered by cyber risk and reacted accordingly, according to Ms Rodriguez Ploss.

She told *Commercial Risk Europe* that the available coverages in Portugal are "very comprehensive" and similar to the cover provided across the European Union. Capacity is high, but awareness among buyers still needs to improve, she added.

"At the moment, there are adequately high coverage capacities available in the Portuguese market. Brokers have reported to me that policies are written by big companies only with sums insured up to a maximum of ten million euros. However, the market is in the early phase of being established here. Many companies still believe that this issue doesn't really affect them yet. But the risks are universal and the media is reporting on cyber incidents with increasing frequency."

The price of the cyber cover is reasonable, according to the insurer. But the high level of compulsory insurance requirements in Portugal means that there is not a great deal of spare budget currently available for "optional" cover such as cyber, she explained.

"From the perspective of some Portuguese companies, the current level of premiums for cyber insurance policies may seem rather high. As a result of the financial crisis and the increased premiums for compulsory insurance policies, the budgets of the companies are not adequate to provide cover for additional risks. The consequence is that, so far, large companies and banks that have greater economic and financial muscle are insuring themselves against cyber risks. However, small and medium-sized companies have generally not been able to purchase insurance protection against this risk. From an insurer's perspective, we argue that the pricing is absolutely adequate and very attractive for clients compared to the real risk exposure companies are facing today," said Ms Rodriguez Ploss.

Insurers and brokers have a lot of advice and help to offer customers in this fast-developing area, she continued. As awareness among customers rises, risk transfer partners should be able to play a critical role in the identification, measurement, prevention and management of cyber risk, she added.

"Risk managers in Portugal are doing what they can to identify and evaluate cyber risks in their companies. The insurer needs to support this process, however, with a risk analysis, for example using questionnaires, or better still working together with the company to implement the process. Prevention of damage is very important for businesses. Very often they don't have the necessary know-how and have a problem as soon as they identify a need to take action," said Ms Rodriguez Ploss.

This year's European Risk Frontiers survey asks whether governments should create cyber pools similar to those established in countries such as Spain, the UK and Germany for terrorism and natural catastrophes.

Some in the market believe this is needed to help develop a more dynamic insurance market for cyber risks and ensure companies are properly covered.

Ms Rodriguez Ploss said she is not sure if Portugal, which currently still does not have a terror or natural catastrophe pool, is ready for government intervention when it comes to cyber. But the introduction of the EU General Data Protection Regulation will surely spur demand for risk transfer and development of the market, she added.

"Contrary to the situation in Spain, there are no pools in Portugal for insuring against major risks like terrorism and natural hazards. It is therefore questionable whether a cyber pool would be able to create a more dynamic market. The same applies to the possibility of legislation to make insurance against cyber risks compulsory for companies. This is an option that is also being discussed in the market here," said Ms Rodriguez Ploss.

CENTRAL STIMULUS

"However, an important stimulus is being given by the European Union General Data Protection Regulation that has to be implemented in national law throughout Europe by the member states next year. If customer data is stolen in cyber attacks, this directive compels companies to inform the affected persons and the responsible authorities about this. If they fail to provide notification, the businesses are at risk of incurring financial penalties of up to €20m. Cyber policies also enable companies to cover themselves against this financial risk to suit their needs. Market players are convinced that this development will generate signif-icant momentum for demand," she added.

> **"Risk managers in Portugal are doing** what they can to identify and evaluate cyber risks. Insurers need to support this process with a risk analysis, for example using questionnaires, or better still working together with the company to implement the process. Prevention of damage is very important for businesses..."
>
> **BEATRIZ RODRIGUEZ PLOSS, HDI**

Commercial Risk Europe has revamped its website to deliver daily news and continues to report the leading stories of relevance to Europe's risk and insurance managers every week in its electronic newsletter. Below is a roundup of the most popular articles published last month. To visit the new website and sign up for the free CRE weekly newsletter, please go to: www.commercialriskonline.com/commercial-risk-europe/

Swiss Re keeps the faith with corporate solutions unit

Garry Booth
gbooth@commercialriskonline.com

@COMRISKONLINE

GROWING CORPORATE solutions will remain a key part of Swiss Re's business plan despite the unit's disappointing result in 2016, according to the global reinsurer's CEO Christian Mumenthaler.

Mr Mumenthaler said the future of corporate solutions had been reviewed but the board still has faith in the business.

He said Swiss Re believes the business will be attractive, noting that the primary space is a highly cyclical but attractive area.

Mr Mumenthaler said that being successful in the corporate solutions area of business requires a good brand name, capacity, underwriting discipline and knowledge.


Christian Mumenthaler

"I think we have all of that. We've been in this business for 20 years or so; I think it's clear that it will take a longer-term view—this is a good business also for Swiss Re," he said.

Mr Mumenthaler said Swiss Re's competitors in the corporate risk business are having an equally hard time.

"So you have combined ratio published runs around 100% right now, which indicates that the market is just incredibly tough and at the level that is basically not sustainable, if you want to make the right profit," he told analysts.

He said Swiss Re will continue to invest in the corporate solutions unit, in the belief that the market will turn eventually.

The corporate solutions unit posted net income of $135m for the full year 2016, sharply down from $357m in 2015. The return on equity was 6.0%, versus 15.5% in 2015. Swiss Re said the 2016 result was hit by continued pricing pressures and large man-made losses, mainly in the US.

Worrying signs that W&I market is growing too fast

Garry Booth
gbooth@commercialriskonline.com

@COMRISKONLINE

THERE IS A DANGER that the warranty and indemnity (W&I) insurance market is starting to overheat, according to Munich Re.

Monika Milberg, head of financial lines at the global reinsurer, fears there is a worrying sense of euphoria surrounding W&I business, with insurers pouring into the market.

"W&I cover is bought for less than 10% of transactions and yet demand has quadrupled since 2011. Market capacity has increased fivefold and currently stands at around $1.5bn," she told *Commercial Risk Europe*.

"Premium has also increased sharply and stands at about $1.2bn. So despite strong growth in demand, the market is characterised by keen price competition on both the insurance and reinsurance side," she added.

W&I insurance is a fairly young cover, introduced about ten years ago. The policies are highly customised products designed to secure warranties in merger and acquisition transactions. They are especially popular with private equity firms selling a portfolio company, because the cover allows them to effectively limit their liability for warranties.

Without cover, sellers usually have to leave proceeds money in an escrow account for years. Acquirers meanwhile benefit from significant investment protection, for instance through higher limits of indemnity or longer policy terms.

With the global private equity sector thriving, the demand for W&I covers keeps on growing.

However, the risks inherent in W&I business are often underestimated by insurers with a strong appetite for the attractive growth and diversification offered by the business, Ms Milberg warned.

In the early days, claims under tightly written W&I policies were rare and profit margins more attractive for the insurance industry. Terms and conditions were very narrowly defined, premiums high and the underwriting process lengthy.

But in recent months, the market has expanded significantly due to additional policy wordings, lower premiums, less burdensome underwriting processes and the popularity of buy-side policies, Ms Milberg explained.

"Such strong growth in such complex business makes it difficult {for insurers} to find suitable underwriting staff. It's really worrying. It makes for very unbalanced and challenging exposure and premium ratios. There's high volatility of loss ratios affecting the profitability of the book. It's important that new market entrants don't underestimate the potential loss situation," she warned.

Managing cyber risk challenges within reach: Swiss Re

Sarah Jolly
sjolly@commercialriskonline.com

@COMRISKONLINE

RISK MANAGERS AND insurers are within reach of tackling the challenges and complexities posed by cyber risks, according to a new report by Swiss Re's sigma. However, the report warns that business must work harder to integrate cyber security into risk management programmes and called on insurers to develop more effective cover.

The report adds that despite progress on the horizon, firms today remain generally unprepared for cyber risk.

The sigma report notes that businesses are increasingly concerned by cyber risk, but need to do more to control a cyber attack or breach. Coupled with cyber resilience initiatives and a dedicated cyber insurance market, the report states that risk managers and insurers "can get to grips with cyber risk".

It adds that business can be helped along by new rules. "Regulation could be a catalyst for change with legislation coming into force in many jurisdictions requiring firms to build enhanced data protection safeguards," the report notes.

Swiss Re chief economist, Kurt Karl, commented: "Firms – large and small – need to invest more in cyber security architecture to develop robust pre- and post-loss risk management capabilities."

But the report stresses that "despite increased awareness of the dangers, firms are generally ill-prepared to cope with cyber risks".

Swiss Re notes that the cyber insurance market is still developing, with an increasing number of insurers looking to write cyber as a specialty line.

"So far the scope of cover is modest relative to potential exposure," Swiss Re states, adding that a typical policy covers losses from data and network security with capacity limits ranging from $5m to $100m.

However, it notes that the development of better cyber insurance solutions using advanced analytics promises to extend the reach of cover and push the boundaries of insurability.

The report concedes that some extreme catastrophic cyber losses "may be uninsurable". It proposes a government-sponsored back-stop for such cyber risks, along the lines of terrorism systems already in place.

Swiss Re believes businesses and risk managers need to look beyond the costs of lost or corrupted data from a cyber breach and consider reputational risk, the loss of physical and intellectual property, and business disruption.

International Programme News

International Programme News [IPN] is a web-based service from *Commercial Risk Europe* publisher Rubicon Media that delivers news and analysis on risk transfer and financing developments at international level. It examines initiatives from insurers, brokers and captive managers to help risk and insurance managers improve the way they manage and transfer their cross-border risks.
IPN delivers daily news and a weekly newsletter. Please go to www.commercialriskonline.com/international-programme-news for the latest stories and to sign up for the weekly IPN newsletter

Global insurance M&A levels set to rebound in 2017

Tony Dowding
tdowding@commercialriskonline.com

@COMRISKONLINE

GLOBAL INSURANCE merger and acquisition (M&A) activity is expected to peak again in 2017, following a slow year in 2016.

A survey of 200 insurance industry executives by KPMG International revealed that 84% of global firms want to target between one and three acquisitions in 2017, with two thirds of insurers interested in cross-border deals. Some 94% of insurers surveyed are planning at least one disposal.

"Insurers are clearly hungry for good M&A opportunities," said Ram Menon, global lead partner of KPMG's insurance deal advisory in the US. The executives cited changes to business and operating models as primary drivers for M&A deals.

"Even with geopolitical uncertainties, they are aggressively looking at deals that can help meet their objectives," said Mr Menon.

Asia-Pacific emerged as the most favoured region for acquisition targets, where 46% of respondents are looking for opportunities. By country, the US is the top location for acquisition targets. Western Europe was identified as presenting the most divestiture opportunities. At the same time, a separate report from Clyde & Co reveals that 2016 was a particularly slow year for global insurance M&A activity, with 387 deals. M&A activity fell to its lowest level since 2013.

Clyde & Co notes that M&A deals were down 13% in 2016, following 444 transactions in 2015. Activity was slower in the second half of the year, with 186 deals. The report shows that 12 of the top 20 largest deals last year featured Asia-based buyers, particularly from China and Japan.

"Last year didn't match what was, in retrospect, a bumper year in 2015," said Andrew Holderness, global head of the corporate insurance group at Clyde & Co.

The report agrees, however, that M&A levels are likely to rebound in 2017.

Hong Kong looks to establish itself as captive and reinsurance hub

Nicholas Pratt
npratt@commercialriskonline.com

@COMRISKONLINE

THE HONG KONG Financial Services Development Council (FSDC) has released a report that calls for action to develop the island's insurance and reinsurance industry, while highlighting the potential of Hong Kong as a captive domicile.

The report notes that Hong Kong's insurance market faces a serious challenge and is lagging behind its Asian competitors in many areas.

"The recent departure and downsizing of the Hong Kong offices of various international insurance and reinsurance companies highlights the need for Hong Kong to further develop our insurance and reinsurance industry," commented chairman of the FSDC, Laura M Cha. "Further departures are likely in the near future if action is not taken."

She added: "Hong Kong has all the necessary ingredients to be a leading insurance and reinsurance hub in Asia. Hong Kong insurers and reinsurers have played a critical role in supporting mainland Chinese companies to transfer and manage their risks, particularly as they expand into new territories, specifically in the regions in the Belt and Road initiative. Mainland Chinese companies and insurers will be able to take advantage of the benefits in terms of efficiency, best practices, language and ease of doing business by transacting reinsurance in Hong Kong."

The FSDC aims to establish Hong Kong as a world-class and leading captive domicile by 2020, with between five and ten captives licensed per year and 50 in total by 2025. It said this is a realistic goal given the number of organisations in mainland China and the surrounding region that have the size, scale, risk profile and growth plans to utilise captives.

The report notes that mainland China has a significant lack of professional risk managers, while mainland Chinese companies have a significant amount of risk exposure, especially to natural catastrophes and business interruption.

"Large mainland China-based multinational companies have been in the process of identifying and quantifying their uninsured risks and have so far found the risks significant. This is a critical exercise as top management understands the downside risk and impact on the balance sheet. As many of these companies are in emerging industries and locations where conventional insurers may have limited risk appetite or capacity, the only way to manage this risk and exposure would be through the creation of a captive," the report finds.

Hong Kong has traditionally been slow to promote the use of captives due to a lack of regulatory promotion, incentives to compete with international domiciles and, to a certain degree, understanding from the financial and corporate sectors of the benefits of—and uses for—captives, the report states.

The mature Asian captive markets of Singapore and Labuan have promoted these for a longer time and have therefore established themselves as regional hubs.

The success of Singapore within the Asia-Pacific region highlights the potential that Hong Kong has within Greater China, the report claims.

Multinational pooling and employee benefit captives have growth potential

Tony Dowding
tdowding@commercialriskonline.com

@COMRISKONLINE

THE USE OF MULTI-national pooling and employee benefit captives is delivering cost savings to companies, but those not actively managing their insurable benefit risks should act now to start realising savings, according to a report by Willis Towers Watson.

Unlocking Potential: Global Approaches to Insurable Benefit Financing—Multinational Pooling and Benefit Captives Research Report 2016/2017 notes that in a world where multinationals seek cost management for competitive advantage, this opportunity represents statistically proven and relatively "low-hanging fruit".

The research reveals that well managed multinational pooling can achieve savings of 15% or more when it comes to employee benefits, while well managed captives can achieve savings of more than 25%. But pooling may not be appropriate for every company, the report adds.

"There are significant cost-saving opportunities for many companies in return for them taking a more proactive and considered approach to the management of their insurable benefits," states the report.

It notes that the number of employee benefit captives has doubled in the past five years to approximately 85. Based on current activity, it predicts the number will double again in the next three years.

"Captives are now an established part of the employee benefit landscape for multinational companies. We are seeing growing interest in expanding the use of captives for some retirement savings and retiree medical risks," states Willis Towers Watson.

The report points out that as finance and risk professionals become more involved in employee benefit decisions, they apply techniques used in the non-life side of their work.

Willis Towers Watson says companies are leveraging vendor relationships through multinational pooling and captive financing strategies to create cost efficiencies. "However, it is clear from our thousands of interactions with multinational companies at headquarters, regional and local levels over the course of a year that one size doesn't fit all when it comes to a strategy for optimising the financing of employee benefits," it adds.

The firm notes that multinational companies deploy "multi-tier strategies" when financing their employee benefits. For example, larger multinational firms may have much higher risk tolerance so often consider self-financing in markets where it makes sense, and employ a captive or aggressive multinational pooling strategy in others.

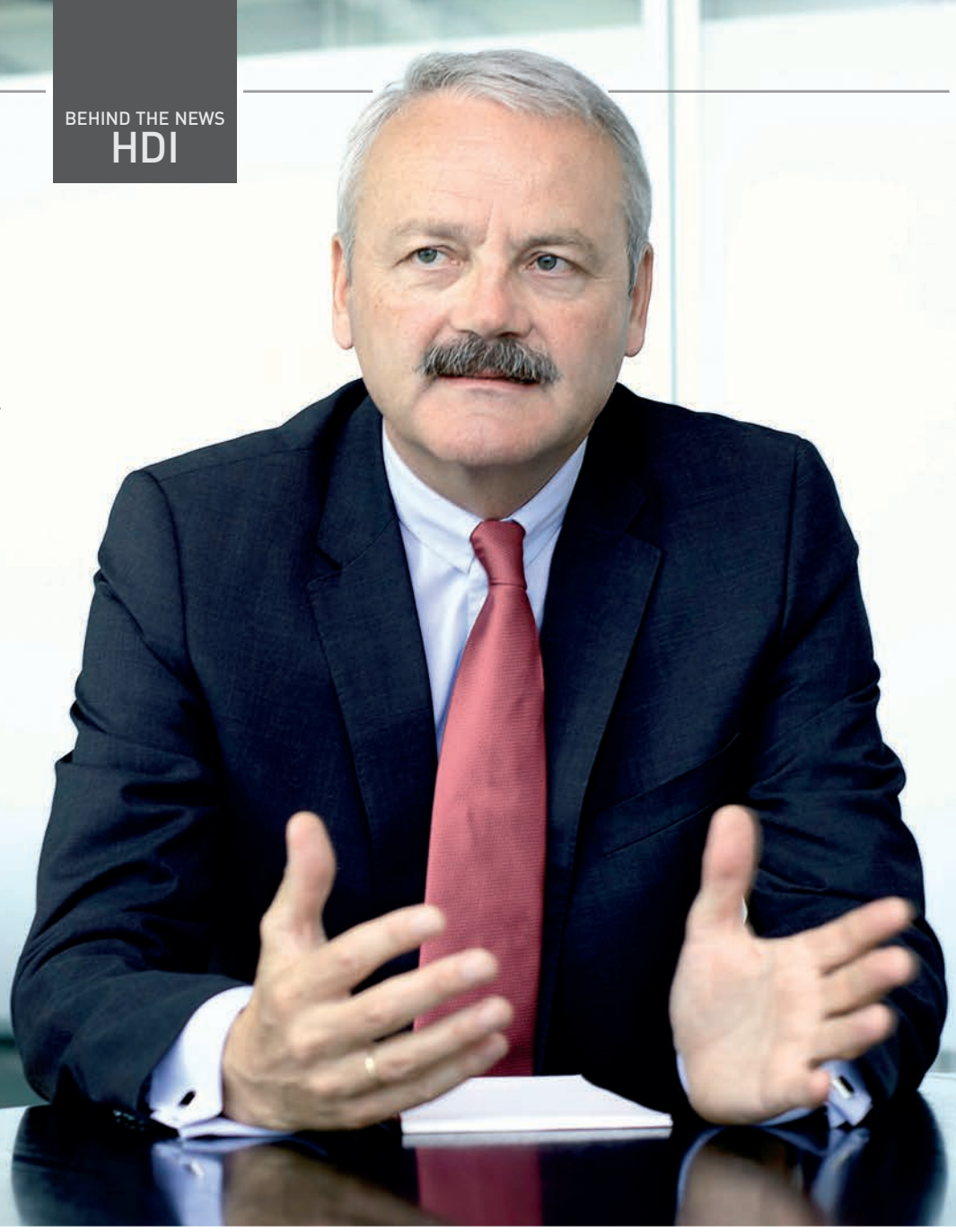
Smaller multinational companies may view risk differently and prefer a protective multinational pooling strategy for particular contracts and commercial insurance where they are unsure of the exposure, states Willis Towers Watson.

The report suggests that multinational companies with a track record of successfully launched global initiatives—including global property and casualty insurance programmes—and good channels of communication, might be in a position to consider captive solutions.

"But a multinational company with little knowledge of its global benefits and limited track record of influencing local decision-making about choice of insurer should be realistic about its short-term objectives and perhaps take a more evolutionary approach," states the report.

HDI Global maintaining a smooth line

Recent results from the international insurance and reinsurance market, not least AIG, have shown once again how difficult it can be to maintain a steady and consistent growth path in this tough operating environment. HDI Global, however, appears to achieve exactly what serious long-term customers and investors seek from their risk carriers. HDI's Dr Christian Hinsch told *Commercial Risk Europe* that, as in motor racing, there is no magic formula. The key is maintaining a consistently smooth driving line, properly assessing the risks and being strong enough to avoid manoeuvres that could lead to a calamitous crash...



◇ HDI

Adrian Ladbury
aladbury@commercialriskonline.com

@COMRISKONLINE

DR CHRISTIAN HINSCH, CEO OF HDI Global SE and deputy chairman of the management board at parent group Talanx, describes the industrial insurance group's 2016 annual results as "quite good", given the continued highly competitive underwriting conditions and difficult investment markets.

Gross written premiums at HDI Global were down 1% in 2016 to €4.3bn, while net earned premiums rose 1% to €2.2bn.

The group reported an underwriting result of €73m for full year 2016, compared with €18m in 2015.

NUMBERS GAMES

The combined ratio improved to 96.8% against 99.2% the previous year. HDI Global said the burden of large losses remained below its target. This led to an increase in operating profit of 42% to €296m from €208m in 2015. Group net income increased by 86% to reach €236m.

The result was unaffected by development of prior years' reserves. HDI Global did not have to post reserve additions as others have done in this latest round of results. So this was a pretty pure result compared to others in the market.

The slight reduction in premium was driven by major re-underwriting of the HDI Global book in its core German market, which commenced in the autumn of 2015.

As Dr Hinsch explains to *Commercial Risk Europe*: "The German book was down while the international business was up. The lack of growth in the German book was due to the re-underwriting to focus on more profitable business. In such an environment you cannot really expect growth and this is fine with us."

The fact that HDI Global's re-underwriting strategy is working was underlined by the improvement in its underwriting result. Dr Hinsch says this performance is explained by three factors.

First, the company's large loss budget was unexhausted by some 20%, mainly because the insurer suffered no major catastrophic events during the year.

Second, re-underwriting of the German property book has led to a reduction in the group's overall exposure. Shares were reduced, prices raised and self-insured retentions increased. Dr Hinsch says a reduction of some €130m in gross loss burden was directly attributable to the re-underwriting exercise. "This was not just luck but a consequence of our re-underwriting exercise," he says.

Third, due to a conservative initial reserving policy, HDI has posted a reserve release for the past 30 years. The release in 2016 was lower than average but investment income was up. This helped boost the return on investment ratio and operating result.

HDI Global's decent results were in stark contrast to some other leading international insurers that were forced to report significant losses because of major reserve additions.

Mr Hinsch was asked how HDI Global managed to deliver a result that was not hampered by such problems.

"If you look at these reserve additions posted by some competitors, this is for business written years ago. Some companies apparently did not set reserves in the appropriate way at the time for their liability business. Liability business is an important part of our book, roughly equal to property, so we know how important it is to reserve properly. Maybe some peers showed better results in past years than they should have done. Another possible explanation is that perhaps they were aggressively growing at insufficient prices. If you do not set your IBNR (incurred but not reported) numbers adequately when you are strongly growing your book, especially in a soft market, then you will have a problem in future years," comments Dr Hinsch.

The more difficult thing is to hold a firm line in a competitive market while, at the same time, protecting your best business.

It is fair to say that HDI Global was subject to a great deal of criticism from risk managers and brokers when announcing its re-underwriting strategy in Germany back in 2015. But Dr Hinsch says that ultimately, the market had to accept the sense and consistency behind its approach.

"I am happy that we have the experts needed to apply an individual account-by-account approach, and so in the renewals of 2015 and 2016 we hardly lost any business that we wanted to retain. We did not have to use a simple ten-per cent-more-on-every-account approach. It helps of course if you are lead carrier as we are, because you have more to offer than just the lowest prices, namely quality service. If you are a follower in this market, the broker can quite easily replace you," explains Dr Hinsch.

NO HARDENING IN SIGHT

Like its competitors, HDI Global would of course benefit from an overall market hardening as we have seen in the past. But risk managers will be pleased to hear that Dr Hinsch sees few signs of that in sight.

"There are no major signs really. If you look back over the last ten years, there has been no true

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hardening. There may have been a few weeks or months of a shortage of capacity in certain lines but it has been shortlived. In this interest rate environment, there is a lot of new professional capacity still entering the market," he says.

Much of the fresh capacity that has entered the market in recent times has come into the international specialty market. There has been a tremendous growth in managing general agents – often owned by brokers – notably in London.

Dr Hinsch says customers really need to understand the difference between this kind of capacity and that offered by major international insurers such as HDI Global.

"I would really see a big difference between the specialty MGA-type capacity typical of Lloyd's and companies such as ourselves. This capacity can go away just as easily as it arrives. With the big international insurers, in the major lines such as property and liability especially, it is a different story," he argues.

Dr Hinsch is a big fan of motor racing and sees a good analogy here. "In racing it is better to have a smooth round driving style. You do not want to go too fast into the curve and have to break suddenly and pass the corner square. Abrupt movements adversely affect your driving line. In our market, such an erratic approach confuses staff, customers and brokers. I would rather avoid completely exiting lines or sectors. This is not our approach. We have to underwrite intelligently and see each risk individually on its merits. If we exit a line completely we would lose also the underwriting experts that help us to distinguish between desirable and undesirable risks in that line in better times," he explains.

HDI Global's reduced appetite for certain marine business and motor fleet in Germany is no secret. But this does not mean that the insurer will simply pull out of these important lines lock, stock and barrel.

"The marine line of business has a very challenging loss history, but if you look closer it is not actually marine in general, it is rather storage risks, especially in the auto industry. This is now part of our balanced portfolio strategy. I must emphasise that this does not mean that auto industry risks are intrinsically bad, they are risks that we look for and like. But the price has to reflect the loss history over time therefore we need some adaption to the current situation," says Dr Hinsch.

One area that HDI Global has fully pulled out of, however, is ocean marine hull. It used to underwrite this cover through operations in Oslo acquired as part of the Gerling Group, but this business was sold to Norwegian insurer Skuld in November of last year.

WHERE IS THE GROWTH?

HDI Global's investors and customers would not, however, be overly impressed if the company was not able to accompany its conservative underwriting story with some more positive growth stories.

One area where Dr Hinsch sees good potential is the middle market in Europe. The bottom line is that these companies, which form the backbone of the European economy, are becoming more aware of their risk profiles, especially as they seek growth in international markets. This represents a chance for international carriers like HDI to generate fresh premiums, explains Dr Hinsch. But it also requires investment to move closer to the customer.

"This needs investment and we are currently expanding our footprint in Europe with new local offices in Glasgow, Lyon and Genoa, for example. In April, we will open in Bern our third office in Switzerland. So, we are starting to get closer to our customers in a literal sense. One of our unique selling points has always been a desire to be close to the customer. This goes right back to our beginnings as a mutual for German industry," explains Dr Hinsch.

But how can such investment for growth be justified when combined ratios, and the loss ratios that underpin them, are rising and there is little sign of assistance from a market hardening or booming investment returns?

In this respect, Dr Hinsch says HDI Global possesses a competitive advantage because at 21.8%, its expense ratio is already lower than most major rivals.

The group also takes a more cautious approach than others, enabling it to expand on a profitable basis rather than as a loss leader. "We do not really have a cost issue. In line with the desired smooth driving style, we do not invest big before the business is there and later may have to reduce big when it does not come. We rather take smaller steps and see how it works out," explains Dr Hinsch.

PRIMACY OF SERVICE

In such a competitive market, one of the best ways of differentiating yourself and convincing the best business to come your way or renew, while standing firm on prices, is to deliver exceptional service. Dr Hinsch is more than aware of this and sees six key areas where his company needs to concentrate its efforts.

First, there is the need to be ever closer to the customer. "This is very, very important. Everyone claims this, but I think I can genuinely say that we are known for this. This is an ongoing process of finding out individually exactly what their needs are," says Dr Hinsch.

Second, any insurer that claims to be serious about this market needs a proper global network. "This sets apart the lead from the capacity providers, the followers," says the HDI man.

Third, there is a need for long-term commitment to this market. There is always a temptation to exit the market, or parts of it – regionally or by segments or lines of business – when terms change. But the wider benefits of the longer play more than compensate for short-term financial gains, argues Dr Hinsch.

Fourth, the insurer needs to display an independent and entrepreneurial, open-minded approach towards risk. This is again something that is easy to claim, but in reality insurers often just follow the pack. Dr Hinsch points to HDI's independent decision to insure year 2000 risks where many others refused, as an example of where his firm breaks the mould.

Fifth, the serious global insurer needs to be able to offer in-house risk engineering support and expertise, says Dr Hinsch. "Some of our competitors claim they have this but I am not so sure. Our risk engineers really have to live and breathe our philosophy and transfer that to our partners," he says.

Finally, and potentially most important in this market, there is claims handling. "To the customer, claims handling is actually the equivalent of the premium. It is the most important of all services for an insurer. Therefore, it cannot be outsourced, it must be in-house, as you can guarantee excellence only if you are in charge," says Dr Hinsch.

> **"I do not see such** automation coming into the corporate business that is becoming more, rather than less, complex..."

PARTNERSHIP AND INNOVATION

Deep and long partnerships are very important when attempting to tackle challenging emerging risk areas such as supply chain, he argues. These must be based on a good deal of trust.

In particular, supply chain is all about lots of quality information and effective exchange of data. "If you have lots of quality data, then there should not really be any problem insuring it. But you do need the data to properly embrace the risk. The problem in supply chain is that most customers do not appear to have that data," says Dr Hinsch.

This area stresses the significance of recent advances in data, technology and analytics within the corporate insurance sector.

The broader personal lines market – motor, household and the like – may well be getting very excited, or scared, about the potential offered by big data for the future of the business and a likely demise of the traditional underwriter. A real revolution.

For the corporate insurance market, data and technology can help support the expert underwriter, rather than replacing the role. It also offers the potential to deliver a more efficient and effective distribution and administrative model. So in this market it is more about evolution.

"We are investing heavily in our back end and front end. We plan to introduce a portal for HDI Global this year. Of course, others already have this so it is not such big news in this sense. What is really important is what lies behind it – hot air or substance! We will only launch this when we are ready with real substance. I do believe that such a digital interface with customers and brokers is the first step to exchanging data on supply chain and other risks that will help us analyse and price such risks and make significant steps forward," explains Dr Hinsch.

Will the rise of such technology radically change the entire insurance model and, particularly, distribution? Yes and no, according to Dr Hinsch.

"This is more a danger for the brokers than for the carriers and clearly more on the retail, personal lines and SME side of the business. I do not see such automation and commoditisation coming into the corporate business that is becoming more, rather than less, complex. I do see a lot of consolidation in the retail broker market, but you will not see an automatic market-wide platform for global programme business any time soon," he says.

Dr Hinsch recognises that the insurance distribution chain is undergoing significant change. It is interesting to see the rise of broker facilities and MGAs in particular. Also, Dr Hinsch understands that customers may not be overly happy with the oligopolistic nature of the global broking community. This will inevitably lead to new opportunities for specialist and flexible independent brokers.

Dr Hinsch would not be surprised to see further M&A deals in the insurance and reinsurance market. But it is highly unlikely that HDI Global will be part of a major transaction while he is in the driving seat.

"We have experience of a major merger with Gerling. It has certainly helped us on our current path but I do not see a major M&A deal for us as a preferred option now. We will continue to grow organically and may see options for acquisition in local markets. A major deal makes sense only in special circumstances because it can seriously distract the organisation for years and add complexity. But we are definitely interested in bolt-on acquisitions here and there," concludes Dr Hinsch.

The international corporate insurance market is becoming increasingly difficult as carriers struggle to balance stubbornly competitive underwriting conditions and low investment returns. There are few signs of this changing, so the recent process of consolidation should continue. This will leave risk managers with a smaller number of carriers willing and able to lead their primary programmes and deliver service on the ground where needed. Paolo Ribotta of Generali Global Corporate & Commercial tells **Adrian Ladbury** that the Italian group plans to be one of this elite

Generali in for the long run

◇ GENERALI

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GENERALI GLOBAL CORPORATE & Commercial (GC&C), the Italian insurance giant's dedicated operation for the corporate insurance market, has made real progress since its launch back in 2013 and is here to stay.

It is now ready to move on to the next big phase in its planned path towards becoming a truly significant player on the multinational insurance stage.

But the Italian group's further European and worldwide expansion in this high value market will not be aggressive or "sexy", according to Paolo Ribotta, head of GC&C. The approach will instead be based on "rigour" and simple delivery of what the customer is promised when contracts are signed, he said.

Mr Ribotta is happy that the previously untapped potential offered by Generali's historic brand, global network, scale, specialty skills and knowledge is finally beginning to be liberated under the GC&C structure.

"We are clearly now moving from startup to run rate phase. We were created in mid-2013 and since then have delivered good, solid results. We are an organisation with premium income of about €2bn already and a healthy combined ratio of about 93%, which is pretty good in this competitive market," said Mr Ribotta.

PRINCIPLES

"We are doing what we said we were going to do when we laid down the principles back in 2013. We have invested in the tools needed, such as our excellent multinational programme platform, and we opened up in Germany last year. We have continued to invest in the US and Asia. The investment in the multinational programme platform is not sexy, but rather about rigour. This is about execution and more science than art. The brokers recognise and appreciate this," he explained.

There are many insurers and reinsurers keen to break into the potentially lucrative corporate insurance market, but many simply do not have the physical representation on the ground to deliver the goods when required. Generali's global network is the cornerstone of the GC&C strategy.

Generali has recently decided to slim down its geographical footprint under new top management structure led by Philippe Donnet, who took over as CEO from Mario Greco after he jumped ship to return to Zurich last summer.

Frédéric de Courtois, CEO of global business lines and international, reportedly told analysts at an investor day last autumn that Generali wants to maintain its international strength. But following a portfolio review focused on profitability, the insurer decided that it could exit 13 to 15 markets where there is not potential for development. If these operations were to be sold they would generate some €1bn in cash by 2018.

However, even without these operations Generali will continue to have an enviable global network, not least a leading position in central and eastern Europe (CEE) and an importantly growing presence in key emerging regions such as Asia-Pacific.

The continuing difficult investment market and stubbornly soft underwriting conditions in virtually all lines mean that cost control is more important than ever for insurers. But customers demand a local presence and servicing capability.

Insurers with serious ambitions in the international corporate and commercial insurance market, especially those that offer global programmes, do not need to be based in every territory to service global programmes. But they do need a good spread of offices in key markets and a decent network of brokers and strategic partners across the globe to help plug the gaps.

GC&C can offer this service.

"We have one French client within the automobile industry that recently set up a supplier programme. This inevitably evolved into a multinational programme in 45 countries and we were able to deliver. We have just bound a programme for a very large construction company present in 30 countries, using our big strength and presence in the CEE markets. We are even providing services to some of our competitors in this region too," said Mr Ribotta.

GC&C offers the main property and casualty coverages topped up by the broad range of specialty lines that risk managers at multinational companies demand in today's market.

GC&C offers aviation, marine hull and cargo. It has a strong construction expertise, while also offering the full range of financial lines and cyber cover.

Mr Ribotta believes that cyber will be the hot topic in 2017 as the European Commission's data privacy and incident reporting rules finally hit the statute book. Management will then face up to the fact that cyber risk is not something to be left in the hands of the IT department and forgotten about.

This risk needs to be actively identified, managed and, where possible, cost-efficiently transferred.

"Cyber is a niche area that is rapidly maturing. We have launched a cyber proposition that offers meaningful capacity of €25m and we have added consulting or risk engineering services too, based upon our own internal cyber security team's work. This is being noticed," explained Mr Ribotta.

He said this cyber solution is based on a strong first-party proposition, to which third-party elements have been added that will cover denial of services. "The market is clearly moving from a property damage trigger and evolving," said Mr Ribotta.

Another important growth area is the infrastructure market. These mega projects involve many different parties of varying size, involved in a myriad of contractual relationships. This creates significant risks that need to be assessed, managed and ultimately transferred.

So where is the real growth potential for GC&C in terms of size of company? Will Generali focus its efforts on the jumbo accounts, upper middle market or middle market?

GC&C does play in the jumbo space, but will focus its efforts more on the upper middle firms, which for Generali means companies with revenues of between €150m and €2bn.

But is this cake big enough to feed the ambitious group?

Mr Ribotta is convinced that this remains a healthy and growing market that is relatively underserved, compared with the jumbo space.

"Since the beginning, we did not call ourselves just corporate, but rather corporate and commercial. Companies of about €150m to €2bn size are the backbone of the European economy and international market leaders in their sector, and this is our play," he explained.

Mr Ribotta said this approach makes sense partly because the jumbo market is evolving and essentially becoming less attractive for insurers.

"The traditional role of the insurers is to provide risk assessment as well as risk transfer. But for the larger, jumbo accounts the focus nowadays is more solely on risk transfer at the catastrophic level. The middle market [companies are] fully focused on growing their business and want help with risk assessment, management and loss prevention, as well as risk transfer. You ultimately have to question whether the jumbo accounts will actually need insurers in the long run as they choose to retain more and more risk and manage their own risks," he said.

Geographically, GC&C's focus remains predominantly on its core European markets, chiefly Italy and Germany. But it is expanding in France and more recently the UK, where it is planning to significantly grow its presence in the national commercial and corporate market rather than just the London international market.

Asia and the US are also big potential growth markets for GC&C, explained Mr Ribotta.

"Asia and the US currently account for some 8% of our business, which is relatively limited and thus offers good scope for growth as in Germany, France and the UK. Again, we are looking mainly at the upper middle market, accounts where we can be truly useful. We are not just a capacity provider. I am seeing accounts where the customer is looking for €200m to €500m excess of €200m. By doing that you are a pure capacity provider and do not need feet on the ground. You can just operate out of London, New York or Singapore. This is not our market," he said.

CONSOLIDATION

Mr Ribotta is one of a growing number who believe that the recent process of consolidation in the corporate and commercial insurance space will continue. This will ultimately mean that the number of serious international players that can offer true service on the ground will fall.

"I suspect that this market is not sustainable. You cannot continue to have this level of capacity with the returns on offer. I would bet that ten years from now, consolidation in the corporate and commercial segment will have continued apace. There has not been much consolidation in the last ten years until recently, because valuations were too high…I would bet that in ten years' time there will be fewer and fewer carriers that are willing and able to do the primary business and servicing required, supported by many capacity providers," concluded Mr Ribotta.

BREXIT: Buffers against unknown outcome of UK's exit from EU

Continued from page 1

"Corporate risk managers in their approach to Brexit need to play a supporting role to the boardroom's decision-making process," it continued. "True, the risks are great for corporate risk managers but Brexit provides an excellent opportunity for a radical overhaul of this position," it added.

When Ms May signalled her intention to leave the European single market, she immediately put passporting rights of UK and EU firms at risk. Passporting rights enable insurers based in the EU to underwrite cross-border.

In reaction to the potential loss of passporting, UK-based and UK-headquartered insurers have begun making plans to set up in the EU to ensure they can continue to serve European companies.

Similarly, EU insurers are also looking to obtain UK licences and/or fronting arrangements. There are more than 500 general insurance companies headquartered in continental Europe that passport into the UK.

But London is Europe's biggest insurance market and home to the world's largest international insurance hub. Many European companies underwrite international and specialty risks in London, while multinational companies from around the globe, including those in Europe, place risks in the market.

It is therefore no surprise that the biggest movers so far have been UK-based insurers looking to retain access to Europe. Late last month, Lloyd's announced it has chosen Brussels as its new EU hub and will set up a subsidiary in the country after Brexit.

Lloyd's said the new company will be ready to write business for the 1 January 2019 renewal season. It will write risks from all EU and European Economic Area states.

Inga Beale, chief executive of Lloyd's, said: "It is important that we are able to provide the market and customers with an effective solution that means business can carry on without interruption when the UK leaves the EU."

Lloyd's also reassured buyers that, for now, it is business as usual at the 329-year-old insurance market.

Despite triggering of Article 50, the UK remains a full member of the EU for at least two more years. As such, there is no immediate impact on existing policies, renewals or new policies, including multi-year contracts, written during this period of time, Lloyd's said.

Brussels was chosen from a shortlist of six locations that included Luxembourg, Dublin, Frankfurt, Malta and Paris. Lloyd's said it opted for Brussels because of its strong regulatory framework. Dublin was the early favourite but it is thought that Brussels and Luxembourg offered more flexible capital requirements, allowing Lloyd's to reinsure more business back to London.

"Brussels met the critical elements of providing a robust regulatory framework in a central European location, and will enable Lloyd's to continue to provide specialist underwriting expertise to our customers," said Ms Beale.

Lloyd's will of course need to staff its EU office, but it does not expect to transfer a large number of employees from London. The insurance market is likely to use the platform to push its brand in Europe.

The decision to locate a subsidiary in Brussels is a positive sign of Lloyd's' commitment and ambitions in Europe, according to Andrew Holderness, global head of the corporate insurance group at law firm Clyde & Co.

"The selection of Brussels as the location for its European subsidiary sends out a strong signal of intent that Lloyd's is not only committed to protecting its existing EU business, but that it has ambitions to use this move as a springboard for further advances in the EU continental market," he said.

The decision by Lloyd's is likely to be followed by other London market insurers. At the start of March, AIG, which currently has its EU headquarters in London, said it is setting up an additional subsidiary in Luxembourg.

Lloyd's insurer Beazley has confirmed that it will open a subsidiary in Dublin, while Hiscox is said to be considering Luxembourg and Malta. Luxembourg and Dublin have both said they have had a number of enquiries from London-based insurers.

As a result of efforts by insurers to restructure, Airmic, the UK's risk and insurance manager association, told *Commercial Risk Europe* that Brexit should have minimal impact on buyers.

"While members would support the continuation of passporting, the insurance market has well developed plans to enable them to continue to provide an equivalent service for clients even if passporting rights are lost in the negotiations," said John Hurrell, chief executive of Airmic.

"There may be some additional administration costs but the overall impact should be minimal on buyers," he told CRE.

European corporates buying their insurance from UK and London market insurers are unlikely to be disadvantaged by Brexit, according to Ivor Edwards, European head of Clyde & Co's corporate insurance group.

"There should be little or no impact on policyholders, although insurers are having to be proactive," argued Mr Edwards.

"Insurers and brokers are working hard to make Brexit as seamless as possible and in that sense, nothing should change for policyholders – other than which legal entity issues their policy," he said.

AIG: US giant concedes it was too slow to address problems

Continued from page 1

team has taken decisive actions to address the issues of the past and place the company on a sounder financial footing. As a result, I am confident that AIG is better positioned today than at any time in the past quarter-century to deliver sustainable earnings growth, with dramatically lower reserve risk," he added.

The huge reserve charge in the final quarter of last year that led to Mr Hancock's demise was fundamentally caused by AIG's failure to react swiftly enough to the problems in its US casualty book.

This was in part driven by the difficult balancing act to retain sufficient quality business while shedding more dangerous lines. The bulk of AIG's highly valuable US and international multinational business is sold on a multi-line basis, so underwriters have had to tread a careful line and avoid losing too much good business by being overly aggressive in other less attractive areas.

But Mr Hancock's parting letter suggests that AIG was perhaps, in hindsight, a little too kind to some corporate customers.

"Having spent considerable time analysing what happened, we concluded that we had historically been slow to recognise the depth of issues within our US casualty business. Over the past several years these ranged from the macro issues of investment returns depressed by persistently low interest rates; the use of a hurdle rate for new business, which was in hindsight below investor expectations; and more micro issues like the slow exit of troubled lines such as pollution-legal-liability and buffer-trucking," wrote Mr Hancock.

"Once identified, we responded decisively through the reserve strengthening in the fourth quarter; the purchase of an ADC; and increasing the levels at which we book loss picks for 2016 and 2017," he added.

The big question now is who will take over from Mr Hancock – and will Mr Icahn and fellow investors mount another attempt to break up the group? Mr Steenland remains in charge and is leading the hunt for a new CEO. His letter to shareholders certainly did not suggest that he is looking to recruit someone to follow Mr Icahn's advice and carve up AIG.

Mr Steenland believes that Mr Hancock and his leadership team set the correct strategy and that the group is back on the front foot and ready to start delivering healthy results.

"During his tenure at AIG, Peter has tackled the company's most complex issues, including his role in the repayment of AIG's obligations to the US Treasury in full and with a profit. He set the course for AIG to deliver higher quality, more sustainable earnings and dramatically reduced reserve risk," wrote Mr Steenland.

"Peter brought together a highly talented executive leadership team. The board has great confidence in this team to continue executing against the two-year strategic plan as announced in January 2016. We remain committed to our financial targets and objectives, including the return of capital to our shareholders and exceeding our expense reduction targets," he continued.

Mr Steenland told shareholders that AIG's board and management "strongly" believe the company is on the right strategic path and that carving up the group is still not on the cards.

"In fulfilling our fiduciary duties to you, the board regularly examines strategic options. We previously rejected a potential split of the company between our commercial and consumer businesses as the analysis showed this to be value-destructive. This analysis still stands," he said.

Mr Steenland pointed out that beyond the capital demands of such a scenario, a break-up of the group would sacrifice the value of AIG's global franchise. He said that across the group's commercial and consumer platforms, AIG sees opportunities to serve its customers through broad solutions.

So the message to shareholders was clear: don't rock the boat, we are on track.

"Looking ahead, I have great confidence in the future of the company. Our balance sheet remains strong and we expect to gain the benefit from actions taken in 2016, with a significantly improved risk profile and a more efficient cost base. Within the businesses, we expect our consumer business to continue to perform well, and for the operating improvements in commercial to positively impact financial performance," wrote Mr Steenland.

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Most of the non-commodity-intensive countries – half of the countries in the region – continue to perform well, benefiting from lower oil prices, improved business environments, and continued strong infrastructure investment.

The potential for the development of corporate expansion and with it, a dynamic and increasingly important insurance market that still remains relatively untapped is significant. However, as the events of the past year prove, businesses need to be ready and flexible enough to cope with the unexpected.

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I. From macro to micro – the changing African picture

The macro economic picture
SPEAKER: Stéphane Colliac, *Senior Economist for France and Africa, Euler Hermes*

Political and country risk big picture including a focus on the elections in Kenya 2017 and Nigeria 2018
SPEAKER: Jan Randolph, *Director of Sovereign Risk, Economics & Country Risk, IHS Markit*

Followed by panel discussion

II. Climate change

How insurance can play its part to build a more resilient African farming sector and what this will mean for African economic development
SPEAKERS: Lovemore Forichi, *Head Agriculture Reinsurance Africa, Swiss Re* & Mikir Shah, *Chief Executive Officer, AXA Africa Specialty Risks*

Followed by panel discussion

III. How to grow and support your insurance business in SSA

SSA insurance protection gap and resilience
SPEAKER: Charles Clarke, *Regional Construction Industry Leader – CEEMEA, Willis Towers Watson*

Followed by panel discussion

IV. The African regulatory landscape – Winning and losing

We look at the direction of African insurance regulation – The drive for local market development and the need for London market players to include training and development in their overseas initiatives
SPEAKERS: Israel Kamuzora, *recently retired Commissioner General, Tanzania Insurance Regulatory Authority* & Praveen Sharma, *Global Leader Insurance Regulatory & Tax Consulting Practice, Marsh*

V. Data security, fraud and cyber risk

SPEAKER: Humphrey Harrison, *Chief Executive, The African Financial & Economic Crimes Forum*

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